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Royal Commission on Banking and Finance

La Federation de Quebec des Unions Regionales
des
Caisses Populaires Desjardins

Hearings
held at
Ottawa

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Wednesday,
July 18th, 1962.

THE COMMISSION

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Toronto, Ontario - Chairman

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Investment Dealer
Vancouver, British Columbia

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Ottawa, Ontario,
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--- At 8.45 A.M. the hearing resumed.

SUBMISSION OF

LA FEDERATION DE QUEBEC DES UNIONS REGIONALES

DES CAISSES POPULAIRES DESJARDINS

APPEARANCES

L'Honorable Cyrille Vaillancourt - Directeur General

Mr. Rosario Tremblay - Directeur de l'inspection

Mr. Andre Morin - Statisticien et economiste

Mr. Marcel Caron - Directeur de l'education

Mr. Paul Emile Charron - Assistant secretaire

Mr. J. A. Boyer - President, Federation des Caisses Populaires d'Ontario

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THE CHAIRMAN: Call the meeting to order.

It is with very great pleasure that I welcome you, Senator Vaillancourt, in your appearance before this Commission today. We have read your brief on behalf of La Federation des Caisses Populaires with very great interest, and I may say even before we enter the discussion with you we have been very much impressed indeed by the development of this very important organization and the part that it has played in the financial and in the social life of the people who are

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served by the Caisses Populaires.

At the outset you may wish to make a submission or read the summary, just as you wish. We have read the brief and any remarks that you wish to make will be very welcome indeed.

SENATOR VAILLANCOURT: I have only a few remarks at the beginning, first, to apologize for sending our brief so late but the trouble for us is it is not exactly the same as a bank or insurance company et cetera, because we have to receive all our own information from individual or local Caisses Populaires and you asked us for many new things for us.

We sent over 500 letters asking every manager of the Caisses Populaires and that is very hard for them to answer directly. That is the first problem. And the translation, we were obliged to translate from French to English.

Just at the beginning I wish to explain to you in our brief we discuss only our own problems, the Caisses Populaires, not of the credit unions -- Caisses Populaires, but only our Caisses Populaires. We co-operate with the credit unions, we have the same spirit and aim, et cetera, but we do not operate on the same plan. The credit unions mostly operate on an occupation basis. Instead, the Caisses Populaires operate on a parish basis. That is why the Caisses Populaires is larger with many thousands of members. When you translate "Caisse Populaire" you do not translate "credit union" or "Caisse Populaire and credit union". You cannot translate them into French

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or English. The name is very hard to translate.

Those are my remarks and after that I can read our summary or do you think it is necessary?

THE CHAIRMAN: I do not think it is necessary unless there is anything special. I think in the discussion the various points will come out and if there is anything to add at any point we would very much welcome it.

SENATOR VAILLANCOURT: For the Commission I think it would be better to discuss it in English but sometimes it is very hard to translate exactly.

COMMISSIONER LEMAN: Well, through the last few days you, yourself, Senator, have listened to proceedings with other associations and so did Mr. Tremblay -- we noticed him in the audience. Let us try to give a good example to all those who will come after us and speak so clearly and loudly that the audience can all hear us. I think probably you were suffering from that disability?

SENATOR VAILLANCOURT: Surely.

COMMISSIONER LEMAN: I would like to ask you a few questions pertaining mostly to the organization of the Caisses Populaires in the province. These are at the beginning of the brief and in giving you references to some of my questions I am going to refer to page numbers in the English text.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: The first question I would like to ask you relates to some text on page A-40.

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SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: The first question I would like to ask you relates to some text on page A-40.

There is an explanation given there of the fact that when there are refunds of interest to borrowers these refunds are proportionate to the interest that has been paid by these people to the local Caisse. What I would like to know are the rates on loans all uniform?

SENATOR VAILLANCOURT: No. It all depends on the size and the age of the local Caisse Populaire. You take a Caisse Populaire of 62 years, the first Caisse Populaire, and that is a bigger Caisse Populaire than your new one and we have a reserve fund, et cetera, and our interest is 5½ per cent and for the last 15 years we refund one-half of one per cent of interest to our borrowers. The net interest is 5 per cent.

COMMISSIONER LEMAN: But within one local are the rates always uniform? If one local makes loans can it change its rates according to the purpose of the loan?

SENATOR VAILLANCOURT: On the notes, ordinarily on the notes the rate is one per cent smaller on notes than on mortgages. If we charge 6 per cent on mortgages, personal loans are roughly one-half of one per cent, but not the Caisse Populaire; it all depends on the size of the Caisse Populaire and the profit made the year before because at the end of the year when a year is finished and we have paid interest on savings we are getting interest from the loans and wherever there are profits after that we put 30 per cent in the reserve and the balance is supposed to be returned to the members.

COMMISSIONER LEMAN: This business of having usually a rate of interest one per cent lower when the

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COMMISSIONER LEMAN: This business of having usually a rate of interest one per cent lower when the

security for the loan is a mortgage is the philosophy behind that, the fact that one is better secured than the other?

SENATOR VAILLANCOURT: No, not only better secured. You know, it is more expensive to deliver 100 notes than one loan on a mortgage. It is more expensive. If you have 1000 loans of $100 each and suppose you have only ten loans of $10,000 on a mortgage it is more expensive for the 1000.

COMMISSIONER LEMAN: That is because these personal loans are generally smaller?

SENATOR VAILLANCOURT: Yes. You know at first when we permit a loan to a member the first guarantee is a moral guarantee and the moral is the same for a big loan or a little loan.

COMMISSIONER LEMAN: Are refunds of interest fairly frequent because I would like to ask you a question about how these work? If they are not frequent perhaps it is not necessary to delve into how you figure them out. Are they frequent or not?

SENATOR VAILLANCOURT: Frequent for the old caisses populaires, but you know we started really with our organization in 1932. Before that, with the largest caisses populaires there is frequently a refund of interest set for the new caisses populaires for 20 or 15 years it is more difficult because we have no reserves. We are obliged to build a reserve. That is the reason, that is all, and, for example, five or ten years ago when the interest on the bonds was only

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3 per cent or $3\frac{1}{2}$ per cent it is very difficult to give some refund of interest to the people because at that time our local interest on the mortgage and on the cost was $4\frac{1}{2}$ per cent and 5 per cent. That is only a few years ago that our interest rate was 6 per cent and $5\frac{1}{2}$ per cent. After that it was according to the bond interest.

COMMISSIONER LEMAN: In very recent years, say in the last two or three years, could you give us an idea of how many locals had no refund of interest and I am talking here separately from any dividend on the shares or interest on deposits? I am asking about refunds of interest to borrowers.

MR. TREMBLAY: I would say it is a small proportion, maybe 10 per cent of the total number of caisses populaires.

COMMISSIONER LEMAN: Ten per cent would be a little over 100 locals that do it?

MR. TREMBLAY: Yes.

COMMISSIONER LEMAN: When they do it what I am curious about is your brief says that the amount of the return varies according to the amount of interest charged on loans. So I would like to give you an example so we can understand how the formula works. Suppose one man had borrowed $1000 from the local at 5 per cent for the year and therefore he had paid $50 interest on his loan and then another man had borrowed $500 at 7 per cent, say, for a different purpose, and he would have paid only $35 interest to the caisse?

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MR. TREMBLAY: Yes.

COMMISSIONER LEMAN: If you give them a refund of interest the man who had borrowed $1000 at 5 per cent and therefore paid $50 interest, would he get more back than the one who had paid 7 per cent on a smaller loan?

MR. TREMBLAY: The way they do it, they give a rebate of 10 per cent or 15 per cent of the interest paid so everybody will get a rebate in proportion to the amount he has paid in interest. So, in the first case it will be 10 per cent of $50 and in the other one 10 per cent of $35.

MR. BOYER: But there is not different rates of interest in the same local. There is only one rate of interest in the one local. They will not be different.

COMMISSIONER LEMAN: That is what I was asking earlier, whether the rates of interest are all uniform.

MR. TREMBLAY: They are generally uniform except for the guaranteed loans with mortgages or to a public body or cases of that type.

COMMISSIONER LEMAN: Well, Senator Vaillancourt earlier told me that even within one local there could be a difference of one per cent on a secured loan as against an unsecured loan.

SENATOR VAILLANCOURT: Yes, that is right.

COMMISSIONER LEMAN: And I now refer you a little further on to page A-44. There you explain to us what happens if for any reason a caisse has to be

liquidated and terminate its business and you explain that there is priority given to the repayment of any loans that might have been made to the local and the deposits will rank right next to that and that the balance of the assets realized will be used to repay share capital and if there is not adequate money to cover deposits the members will be asked to complete the payments of any capital that has been subscribed but not paid. These liquidation priorities, are they prescribed by law or are you just explaining how it is worked?

SENATOR VAILLANCOURT: No, by law.

MR. TREMBLAY: We come under Section 3 of the Companies Act for the winding up, so we have to proceed for the winding up or in a bankruptcy case in the same proceedings as would an ordinary company. We follow the same order of preference in the payments of the liabilities.

COMMISSIONER LEMAN: That is just the general law.

MR. TREMBLAY: Yes, just the general law.

COMMISSIONER LEMAN: On the next page you make quite a point through your brief and through the history of the caisse populaire about the educational value to your members especially in the field of learning the practices of thrift. Did you ever think there was anything peculiar about Quebec in this respect as compared with other areas of Canada or other countries? Do you find that Quebec already tended to be very thrifty, especially in the rural areas or not?

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SENATOR VAILLANCOURT: We have had our experience especially in Quebec, but you know the educational, that is very hard, not only educational in general but any kind of education is a very, very long way to Tipperary. We have organized this educational plan especially in the schools because it is very hard to educate a man at 60 or 70 years of age and we started at the beginning in the first year of the organization of the caisses populaires. They organized a school savings plan in the city of Levis and in the first year they collected around $500 in cents and he was very, very happy. But for our experience, take my proper city of Levis, five years ago I was on the board of directors of the school and we started to educate the school for saving and at the beginning we arrived with as good results in the lower class at six years, seven years, and the upper classes, eleven, twelve years, school organizations apparently no results -- nothing.

You know these young people of ten and twelve years, they have no training and they spend all their money et cetera, and this year we have the best result of the upper class than the other and that is the result of education for five or six years.

COMMISSIONER LEMAN: Senator Vaillancourt, at least the reputation of the French Canadian in the rural areas was that he was thrifty, but perhaps he did not know how to use his savings very well.

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virtuous people in Quebec than any other place.

COMMISSIONER LEMAN: I got the impression from the text on page 46 that primarily the purpose of the caisse populaire was not to make business loans. To what extent are business loans made in the system now?

SENATOR VAILLANCOURT: We operate without members, with our members, and it was built by Mr. Desjardins who owned our members in the local area. We do not go into the field of the bank organizations to borrow money. We cannot do that because we are not in training for that. We have no expert for that in our organization but on the local plan the accredited members of our organization know the people and know for what reason these people want some money for doing so and so, and if it is possible they want money to organize some furnishings and so on, they are not prepared to go in this business and they will refuse that.

You know, we use first the money where the money is produced and we send the surplus to the central organizations and in the rural organizations we can do a very large business there. That is only with the farmers and the local labourers there, et cetera.

COMMISSIONER LEMAN: Suppose one of your members should be a store owner, a merchant, and it is not an incorporated business but he is in business, would you refuse him a loan if he wants to use it for his business?

SENATOR VAILLANCOURT: We give the loans to

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SENATOR VAILLANCOURT: We give the loans to

these merchants with a guarantee on a mortgage. We do not loan on the merchandise, et cetera. We take a mortgage, I suppose $10,000, and in one month he wants $1,000 and in another $2,000 and goes back to $1,000 et cetera. It is up and down, but guaranteed by a mortgage.

COMMISSIONER LEMAN: But in fact this would be a business loan in that sense. He might be using it to finance his inventory. You understand that basically his needs may go up and down so he could be using it for his business.

SENATOR VAILLANCOURT: Yes, for his business. The banks might take the guarantee of inventory, but we cannot take a guarantee on inventory. That is the reason we take a guarantee on a mortgage.

COMMISSIONER LEMAN: Do you have any statistics showing that?

SENATOR VAILLANCOURT: Oh, that is not more than one per cent, sometimes.

COMMISSIONER LEMAN: On what might be deemed a loan, but very, very small?

SENATOR VAILLANCOURT: Yes.

MR. TREMBLAY: And it will be done in the localities where there are no banks.

SENATOR VAILLANCOURT: You know, we have over 500 places in Quebec, but no banks were established, and in those places we are obliged to furnish it.

COMMISSIONER LEMAN: I see on page 191 you do give us some statistics on the distribution of the types of loans that are made, and these statistics show that they are fairly small?

SENATOR VAILLANCOURT: Oh, very, very small.

COMMISSIONER LEMAN: I would like to refer you now to page A50. Does the caisse populaire apply new issues quite often that come out on the market; say, municipal issues, that sort of thing? Are new issues often bought?

SENATOR VAILLANCOURT: Except to buy from the ---

COMMISSIONER LEMAN: Well, when a new issue would come out; often they come out through an investment dealer and I want to know if you often buy new issues?

SENATOR VAILLANCOURT: Oh, yes, especially in the schools in the municipality.

COMMISSIONER LEMAN: Does the caisse populaire sometimes make a loan directly without going through -- not going on the market -- through an investment dealer?

MR. VAILLANCOURT: Sometimes, especially in the locality where we are alone; where they have no branch of the banks and before the municipality collects the

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taxes we advance small loans, $10,000, $20,000, $40,000, it all depends on the size of the locality, but not more than that, but when the locality put on the market some loan -- ask for loan -- we ask the locality first if you want to take some parts of these loans through organized market for them on bonds, and we take the shorter term and we leave the longer term for the insurance, and so on, other organizations.

COMMISSIONER LEMAN: Would you sometimes put in a bid for it where the municipality works on a bid?

SENATOR VAILLANCOURT: No, except for a little locality where they are asking us, "Do you agree to borrow $20,000 on bonds?", and at that time we lend the money at the same prices as we lend to our own members, but that is only very, very, very few.

Ordinarly, any locality or school board, and so on, put an advertisement in the paper asking for public issuance, and after that we buy some bonds, but ordinarily we take shorter terms for the school, the parts guaranteed by the government, that is all, and the balance is going on the free market outside.

COMMISSIONER LEMAN: You want them to test the market, you don't want to make private deals with them?

SENATOR VAILLANCOURT: Very few. Sometimes, but a very small area.

COMMISSIONER LEMAN: Could it happen that the church might make a loan?

SENATOR VAILLANCOURT: The same thing with the school or municipality, the same thing.

taxes we advance small loans, $10,000, $20,000, $40,000, it all depends on the size of the locality, but not more than that, but when the locality put on the market some loan -- ask for loan -- we ask the locality first if you want to take some parts of these loans through organized market for them on bonds, and we take the shorter term and we leave the longer term for the insurance, and so on, other organizations.

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COMMISSIONER LEMAN: On page 61 you explain how the local caisses populaire is managed;that they always have to have a president, vice-president, secretary, etc., but that they will also have a manager and when they have a sufficiently large unit the manager will be a paid employee, but you also explain that sometimes the manager could be the president of the local?

SENATOR VAILLANCOURT: That is the exception. You know, some places on the North Shore where there are fishermen, and so on, you have perhaps a dozen people with very good training in these organizations, and sometimes we are obliged to have the president and the manager as the same man, and you know for myself that I am the manager and president of our local organization in the Quebec area, the central organization, and I am the president and the manager, because I know we have some people who can do better than I, but they are patient with me because I am in the field for over 50 years and that is the reason, that is all.

COMMISSIONER LEMAN: But not generally?

SENATOR VAILLANCOURT: No, not generally.

COMMISSIONER LEMAN: It is not usual for the two functions to be together?

SENATOR VAILLANCOURT: No. The secretary and the manager, yes, that is usual, but not president and manager.

COMMISSIONER LEMAN: And then going on a little bit further and still in the organization of the locals there, one of the bodies is one which you call

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the Board of Supervision and you explain what its functions are; it is supposed to represent in effect shareholders and be sort of a watch-dog for the operations of the locals. How effective are the boards of supervision in fact, are they very active?

SENATOR VAILLANCOURT: Mr. Tremblay will answer to that.

MR. TREMBLAY: Well, I would say that a certain per cent of the supervisory are quite active and perform a very good job. In some other cases they may meet less often, and maybe by lack of knowledge of accounting practice they will only meet three or four times a year, but then again they will perform quite a good job by making a perusal of the last inspector's report and see that some of the major points are correct, but unfortunately with certain personalities, who are probably high, I would say around 40 or 50 per cent of cases, the supervisory committee do not function as well as they should.

Now, in the big caisse populaire it is frequently impossible to perform the duty the way they do in the smaller credit unions because of office hours, because of the time locks on the safes of the vaults, and they cannot get in after the offices are closed or over the weekend, so in the larger ones even if they wanted to it is pretty hard to perform their work the same as they do in the rural district in the smaller region.

COMMISSIONER LEMAN: But do you feel that that institution in the system is really worthwhile?

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COMMISSIONER LEMAN: But do you feel that that institution in the system is itself, [illegible]

MR. TREMBLAY: Well, we feel that it must be maintained because I forgot to tell you that in some of the larger caisses they might hire outside auditors -- that is rather infrequent, but it happens -- and they have the highest power in the society and they have the right to go to the manager if anything is found to be incorrect in the management of the society, so they are vested with very strong powers, and as inspectors we feel that we have a supervisory board. Even if he was inactive in practice he would be very useful in such a caisse if the federation or the inspection department found out some irregularities and we had to take some kind of action, because really they are vested with all the powers.

COMMISSIONER LEMAN: Well, have you any figures on how often, for instance, this supervisory board has appealed to the shareholders over the head of the board of management?

MR. TREMBLAY: Well, that would be very rare. In my personal experience of over a quarter of a century in this line of work I only know of a couple of occasions. We don't have to resort to this means usually; we get the solution before that.

COMMISSIONER LEMAN: It is just a reserve kind of ---

MR. TREMBLAY: It is a last resort means of action.

COMMISSIONER LEMAN: On page 73 you make a point of the fact that the regional body do not loan money to affiliated units to enable them to give loans

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COMMISSIONER LEMAN: On page 75 you make a point of the fact that the regional body is not loan [illegible] affiliated units to enable them to give loans

to shareholders, but nevertheless you do explain that sometimes these regional bodies will make loans to units; what is the purpose of the loan when it is made?

SENATOR. VAILLANCOURT: The purpose of the loan is this. You know we have rural organizations, local caisse populaire, rural places, and the others are in the city.

During the springtime, April, May, June, July, and so on, the local rural organizations sometimes are obliged to borrow money because the farmers in the springtime want more money for feed, for farm machinery, and so on, to organize his planting for the summer, and very often the money will come back.

In the city it is the contrary; they arrive in November and December, people want their money to pay the taxes, to pay for the gifts for Christmas, and so on, and you know it is different during the year, and sometimes -- I remember in 1959 when the tight money arrived, the local caisse populaire was not very, very liquid and there were negotiations with the local, and so on, but we never borrow money through the local and for this local to borrow money for loan to their members, never.

COMMISSIONER LEMAN: So, whenever there are loans they are strictly seasonal and very, very short?

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MR. TREMBLAY: And this is to prevent the local society from selling this bond at a loss, at a very heavy loss, and in a small society where the reserves are small, to take a 10 point loss on an issue of bonds might wipe out all their reserves, so the central will step in and make a loan secured by these bonds, and the local society by stopping immediately all the loans and collecting what is coming due or what they can, and they recuperate, and in the measure that they do recuperate they reimburse the central; it is a temporary business.

COMMISSIONER LEMAN: We will get into this business later of the reaction of the whole system to monetary conditions; I don't think we had better discuss it just now.

You describe at great length here your inspection system, and I think that you have reason to be very proud of it and you seem to be very proud of it. You refer in one spot to the fact that there is a subsidy involved to the province to help the system with its inspection system. What does this subsidy amount to now?

SENATOR VAILLANCOURT: $90,000, but we spend a lot more than that; we receive $90,000 from the government and the balance is furnished by the local caisse populaire.

COMMISSIONER LEMAN: What proportion of the total ---

SENATOR VAILLANCOURT: It is one-seventh, I

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think, from the government and six-sevenths from us.

MR. TREMBLAY: The object of the federation is approximately $1 million so we get $90,000 out of it.

COMMISSIONER LEMAN: But the budget of the federation is not all for inspection, is it?

MR. TREMBLAY: No, but approximately 60 per cent is for the inspection and that is the external services alone and a lot of the internal services of the federation are entered in the books as general administration and are also indirectly for the inspection service, like the secretaries and the stenographers, the rent, the light, legal services and advice from the audit department.

COMMISSIONER LEMAN: When the movement was starting, I can well understand why such a subsidy was necessary to help the movement and to get good quality of inspection, but now-a-days what do you feel justifies a subsidy on this?

SENATOR VAILLANCOURT: I think that is justified because the government is not obliged to supervise, and if the government took the supervision and inspection of all local caisses populaires it will spend probably millions of dollars, and more than that, and this is the reason why the government gives $90,000. That is a very good thing for us.

MR. TREMBLAY: You take the fact of distances, for instance; we go to 900 miles, from Quebec right to practically Newfoundland, it is 16 miles across the Strait, and these are not easy localities to get to. You also have the Magdalen Islands and the Gaspe

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Peninsula and Temiscamingue, and we have to cover all that ground and a lot of these people would never have any kind of banking facilities if we didn't do this. There is no privately owned company that would think of opening up a branch of some kind in these small places and we were the only one to go and make -- take the necessary steps to organize these people and help them out and do the promotion and the education and organize study groups and get them going, and even after that they didn't have a big choice of trained people in accounting. So, the first thing you know is the books are all out of order and you have to do the accounting for them once or twice a year, and then they are not very legible pieces of chequing, and things of that kind, or they get caught up in N.S.F. cheques, and things of that kind, and we have to send somebody to get them out of the hole, and that costs more than $90,000 a year. It costs a fortune, and if the government ever tried doing it, why, I agree with Senator Vaillancourt that they will find it costs them not $90,000, but you can put at least a couple of zeros behind it.

MR. BOYER: I think on this matter of subsidy that it could be said in the Province of Quebec the government has no inspection service for the caisse populaire; the government relies on the federation to do this. In other provinces there is a whole staff of government employees to do this work, so I would surmise that the government of Quebec is saving money by giving this $90,000; it would be less than if they

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had to organize their inspection service, so it is costing less to do it this way.

COMMISSIONER LEMAN: Of course, there is nothing that would stop a government from having an inspection service and assessing the cost on the inspection. It is done in quite a few other fields.

SENATOR VAILLANCOURT: But every local caisse populaire every year is obliged to report to the government, signed by our inspector -- once a year. That is not only our reports; it is all the details of the work of the local caisse populaire, and this report is sent in.

COMMISSIONER LEMAN: I don't blame you if you can get it; that is very nice. Would you explain to us a little what is the real authority of the parent organization in the field of inspection? Is inspection compulsory for every unit in the system?

SENATOR VAILLANCOURT: Yes, according to the law every local caisse populaire is obliged to be inspected by us, or they are obliged to pay for inspection by the Minister of Finance.

COMMISSIONER LEMAN: What is the real authority of these inspectors? What can they do if they find something that is not quite according to the rules?

SENATOR VAILLANCOURT: In the past the situation was not the same, because in the past all the people were supposed to be honest, but now there are some temptations to change a little bit, and if we discover something wrong in the local caisse populaire we advise, first, the supervisory board, and the board of directors, and if there is no change we have the right to advise the government, and the government sends

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the proper inspectors. After that the government can do what they think is necessary. However, in 99.9 per cent of their cases we settle the situation direct with the local caisse populaire.

COMMISSIONER LEMAN: What are your weapons? Can you suspend a unit?

SENATOR VAILLANCOURT: No, not according to the law, but we expect at the next session we will have this authority to suspend directly. When we arrive at the local caisse populaire and discover some theft or something we have now asked that the law be changed and that we have the right to suspend the manager or any of the people. According to the law the manager and every person working in the caisse populaire is obliged to furnish a bond or insurance guaranteeing their honesty, and if we discover something wrong we advise the insurance company and immediately they say, "After today we cancel the insurance", and they advise all the board of directors and the commissioners and so on, and that is enough.

COMMISSIONER LEMAN: That is firmly effective?

SENATOR VAILLANCOURT: Absolutely.

COMMISSIONER LEMAN: But does the government, despite the fact it has left the inspection system to the federation, check on the quality of inspection? Does it go over with you the methods used in inspecting all the procedures?

MR. TREMBLAY: We report once a year to the government. It is in the contract that we must do at least one inspection a year, and at the end of the year

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COMMISSIONER LEMAN: What do you refer to when you talk about the permanent inspection of the regionals?

MR. TREMBLAY: That point is to cover up the incapacity of the supervisory board to perform any kind of intelligent audit or work in their proper function. They are benevolent officers and you cannot expect a man to take control of a central with 50 or 60 employees and with a turn-over of 60 or 70 thousand cheques or orders of payment a day. It is so complicated: We have at times as many as 20 or 25 senior inspectors to take complete control of the vaults and the chest and the clearing, the incoming mail and the outgoing mail, and only well trained personnel in that line of business can do that type of audit. It is about the same thing as the inspection of a main office of a chartered bank. They may prepare that inspection for months ahead of time and will go over there with a

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big staff.

We call it "permanent inspection" because we feel the turn-over has become so large that they also act as custodians. They do the safekeeping of the bonds owned by the local societies. So, they are really trustees for millions of dollars of bonds. So, we feel we have to go more than once a year, so we organized a special department within the inspectors' department with trained men, trained in the clearing operation and the central operation, and when they come in to take control three or four or five times a year we add to that the necessary extra staff to perform the start of the inspection and they do the rest themselves. That is really to supplement what the supervisory committee cannot do at that level because it is too big.

COMMISSIONER LEMAN: Is it permanent in the sense that you have a staff of inspectors that stays with that region?

MR. TREMBLAY: All year round, and in the bigger ones, in fact, we may have at least one man, and sometimes more, who will be there practically all year round -- all the time, checking out things and doing some different types of spot checks according to whatever plan we make at the beginning of the fiscal year.

COMMISSIONER GIBSON: He acts as a sort of an office auditor?

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procedure, the routine, and if there is anything that seems to offer a loophole for an employee to go on a side-track, we will discuss it immediately with the authorities and take the necessary steps to correct it.

COMMISSIONER LEMAN: When the inspection is made of a local they make a report of their inspection to the board of that local: Do they send a copy of their report to the regional or the big federation?

MR. TREMBLAY: The report is not made to the local society. The report is made to the federation. The inspector is working not for the local society, but for the federation. The report is sent in four copies to the federation where it is analyzed first, and then we make moral recommendations, and in certain cases if there is anything wrong a special report is made to the board of directors or the executive committee of the federation. In those cases that special report that is taken over to the board of the federation is also sent to the regional unit for action, and in all cases the report is sent by the federation to the president of the local society under registered mail -- never to the manager -- and the letter to the manager saying that the inspectors' report has been sent to the president under registered mail, and a copy sent at the same time to the regional unit with the proper comments of the federation on the subject.

COMMISSIONER LEMAN: Does the board of management of the local get a copy of the report of the inspector that is sent to the federation?

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MR. TREMBLAY: Yes, but they get it by the federation, not from the inspector. While the inspector is performing his work, and before it is over, he will discuss his findings with the manager and the local officers and before he leaves he will generally -- in 75 per cent of the cases -- convene a joint meeting with the members of the three committees -- the board of directors. the credit committee and the supervisory committee, and discuss with them the findings of the inspection. So, even before the report comes in they will know what is wrong and what is right and they make appropriate plans to remedy whatever situation may arise.

COMMISSIONER LEMAN: Because I have seen reports of auditors in other types of concerns, like in my own business, and sometimes the auditors will make a note that there was weakness in certain accounting procedures but that this, after discussion with the local accountant, has been corrected.

MR. TREMBLAY: That is right; that is what we do.

COMMISSIONER LEMAN: Do you have a systematic system of rotation of inspectors so it is not always the same inspectors?

MR. TREMBLAY: That is automatic. It is the secretary of the service who makes the programmes, and we make it a matter of practice never to send the same inspector more than once to the same caisse populaire or, if he goes a second time, generally he will not be in charge of the inspection. So, there is

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a complete shift all the time; we are very careful of that. I must insist all these inspections, whether in the local societies or the central, that I am the only one with the authority to decide when and where -- the only one of the staff to make a decision on that. It is always unknown to the local society. We never give prior advice to the local society -- "Get ready, we are coming".

COMMISSIONER LEMAN: It is a surprise audit?

MR. TREMBLAY: Surprise audit all the time.

SENATOR VAILLANCOURT: And if we have some suspicions we go two, three or four times.

MR. TREMBLAY: We go as often as necessary; we repeat. Let us say we finish an inspection yesterday: We may start again this morning, or next week. If we have suspicion, we get after them until the problem is settled.

COMMISSIONER LEMAN: There are now a very large number of units in the system: What is the record of units terminating business, going into liquidation, say, over the last 20 years or so.

SENATOR VAILLANCOURT: 62 or 67.

MR. TREMBLAY: I have it here: Over the last 16 years there have been 70 closed societies. Out of that there are 47 local or ordinary caisses populaires; also , a kind of savings organization for use, one being for the girls and the other one being the boys; there were eleven of those. Those have been married to the local society. They were really independent societies. There were eight college units in schools

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and four others. For your information, only five of those 47 local societies were urban societies; 42 were rural. They would be mostly located in the Gaspe Peninsula and Temiscamingue, and one of the reasons for closing them is not for the lack of need of saving; it is because it is practically impossible to have a trained man or a trained person accepting work for nothing and keep that little credit society with $3,000 or $4,000 of assets, and we keep on changing managers and treasurers all the time. So, in some cases we had to close those. The rest are spread all over the province: There would be one in Chicoutimi; one in Sherbrooke, and different localities.

COMMISSIONER LEMAN: Can the members usually manage to join another caisse when that caisse is closed?

MR. TREMBLAY: It is not always possible because you have to take into consideration in any rural district the territory of the parish would be such that there would be ten miles distance between the villages, and it is hard to ask somebody to go ten miles away to the other locality to do his caisse populaire business. So, it is really a bad thing for the population to be deprived of their services, because there are no banks in those localities for miles and miles -- sometimes 25 or 40 miles.

COMMISSIONER LEMAN: These were just closed and liquidated because they were not what we call viable?

MR. TREMBLAY: Without losses of any kind.

COMMISSIONER LEMAN: Are there some, for one reason or another, that went bankrupt?

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COMMISSIONER LAMAN: Are there some, for one [illegible]

MR. TREMBLAY: No. There is only one and it is because they wanted to. We did everything we could to help them out and, as a matter of fact, we had them out of the hole at the time but they decided they were smarter than the authorities. The Senator, himself, went over there and we took a lot of trouble to try to get them out of the ditch, but they said, "To heck with you". We could have helped them out completely, as we have done in other cases. We have ways and means of getting out of bad spots.

COMMISSIONER LEMAN: It was just not well managed. Has another caisse been founded in the same territory since?

MR. TREMBLAY: Unfortunately not.

COMMISSIONER LEMAN: You also have in the system an insurance organization, and here I am not talking about a life insurance society, but the insurance that you have organized to cover losses of caisses that might occur for one reason or another. Do you feel the insurance coverage now is sufficient to cover all possible losses? Is there any record of losses that the insurance did not quite cover?

SENATOR VAILLANCOURT: Yes, sometimes, but we have a special fund: When the caisses populaires pay their contributions to the central organizations, and the regional organizations, we take 10 per cent from that to organize a special fund -- a security fund -- and sometimes it is for burglary, theft or embezzlement.

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MR. TREMBLAY: It has happened in a few cases that the amount of coverage has been insufficient to cover up the loss but it has been very rare -- very rare. I might think of maybe five over a period of the last ten or fifteen years. Now, even in those cases there might be possibilities of recovery over a certain period of years. Actually, the insurance policy, the blanket policy that we have I presently feel is very good. We were insured before by private enterprise in the insurance field. Now it is insured with our own insurance company and I, personally, have worked on this problem for several years starting back in 1935 and we have evolved a type of blanket policy that suits absolutely well the needs that we have, so I feel very strongly that we have better protection than any insurance can give us because they would not probably have special policies for that type of business that we are handling.

COMMISSIONER LEMAN: What sort of physical means of protecting assets that could be stolen or lost are used for the small caisses? Do they keep their valuables in the back as much as possible, or keep as little as possible on the premises?

MR. TREMBLAY: They might have safes. Of course, if it is a very small caisse populaire just starting up they have no money and they will have a cheaper type of safe, but it is less dangerous because they have less money, they are small. As they grow up they will feel the necessity to get a better safe with a better chest and if they still do not have time

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to build up the proper reserves then some regional unions will help them out in supplying them with a fairly good safe and chest until they can repay it over a period of years or amortize it over a period of years.

On that point we have been doing quite a bit of work in recent years because of this epidemic of thefts and burglaries to get the best we can for the society. Of course, you cannot expect to have a $10,000 safe for a $25,000 caisse populaire -- it would be ridiculous, but we try to have the best for the size of the society. If it so happens that their safe is not a top quality safe, we take great care in seeing that they carry the smallest amount possible in cash and put all the securities in custody in the central.

COMMISSIONER LEMAN: I think I would like to give some other Commissioners a chance to ask questions.

COMMISSIONER BROWN: You mentioned once before that the centrals are trustees for the locals for millions of bonds. You just now made reference to the fact that the centrals act as custodians for the bonds for the local caisses. Is this a general procedure? Does central usually hold the securities belonging to the units?

MR. TREMBLAY: Yes, they have the proper vaults and organization and proper insurance coverage, armed guards and everything.

COMMISSIONER BROWN: I thought I would follow that up because the questions I want to ask now are more on the distribution of assets -- not distribution

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physically but the distribution as between types of assets. In your brief you mention that cash is usually maintained at a 15 per cent ratio, 5 per cent in the local in the form of currency or till money and in the chartered banks and 10 per cent on deposit with the central. This is not a legal requirement but I was going to ask you what is the general practice with the centrals?

MR. TREMBLAY: The general practice on what?

COMMISSIONER BROWN: Well, what percentage do they keep in cash?

SENATOR VAILLANCOURT: At the central?

COMMISSIONER BROWN: Yes.

SENATOR VAILLANCOURT: Oh, 50 per cent.

COMMISSIONER BROWN: I notice that although you say that it is generally maintained at 5 per cent in the locals, the statistics do not show this. They show it running at less than 5 per cent, is that correct?

MR. TREMBLAY: I do not think so.

COMMISSIONER BROWN: On page 185 of the French version.

MR. MORIN: You have 250 deposited in central.

COMMISSIONER BROWN: We are talking about cash, 5 per cent maintained at the locals. In this case it shows a total of 14 plus three which is 17.6 out of 687, so that is less than 5 per cent.

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MR. TREMBLAY: But the cash on hand must be as low as possible to minimize the risk of burglary

or holdups. We do not have to keep hardly anything and we put it in the central as soon as possible and get some return on it and have it protected.

COMMISSIONER BROWN: All I am getting at is you say it is maintained at 5 per cent.

MR. TREMBLAY: It is not the operational rule. It will vary greatly between the local societies. In certain cases they may need more than 5 per cent in cash in the drawer because they have a bigger volume of business transactions; in some other cases they hardly need any.

COMMISSIONER BROWN: So this general rule is very flexible.

MR. TREMBLAY: Well, it is flexible, yes.

COMMISSIONER BROWN: I just know it runs down to about three in the local, but your overall is about 9 per cent or 10 per cent.

MR. TREMBLAY: Yes, because of the big amount that the central keep liquid.

COMMISSIONER BROWN: One question on that. The deposits with the centrals that the centrals keep in chartered banks, do you keep those just in a current account or are they on deposit, that is, earning some interest for you?

SENATOR VAILLANCOURT: No, current account.

COMMISSIONER BROWN: No interest? You do not use 90 day deposits?

SENATOR VAILLANCOURT: No.

COMMISSIONER BROWN: Have you tried to use 90 day deposits?

SENATOR VAILLANCOURT: Yes, and for 90 days we prefer to buy some government treasury bills.

COMMISSIONER BROWN: We have heard some other financial intermediaries who said they were able to put them on deposit for 90 days to get interest and they could take them out before the 90 days and sacrifice the interest if they needed them. Now, have you tried this?

SENATOR VAILLANCOURT: Oh, sometimes we have some special agreement with trustees or some trust company for 90 days, but very few. We prefer to borrow treasury board 90 days.

MR. TREMBLAY: If they could give us a big rate of interest we think that we can do as well as they can as a general rule.

COMMISSIONER BROWN: Your cash ratio on a consolidated basis is running, as I said, around 10 per cent, -- it is just under 10 per cent. Now, this is considerably higher than the credit unions run on a consolidated basis. Can you explain why you prefer to keep it around 10 per cent?

SENATOR VAILLANCOURT: You know our experience, especially in 1939 when the situation was very, very scarey, et cetera, and at that time we had some trouble. I do not like to come back to this time. That is the reason -- our experience.

COMMISSIONER BROWN: Your experience has made you be very conservative?

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COMMISSIONER BROWN: Similarly your liquidity ratio in the form of cash and marketable securities runs around 50 per cent?

SENATOR VAILLANCOURT: 40 to 50 per cent.

COMMISSIONER BROWN: It was 35 per cent before the war. Why did you change it to 50 per cent after the war?

SENATOR VAILLANCOURT: The same argument and the same answers -- our experience. In 1959, which is not very long ago, we had some trouble with some caisses populaires having only 30 per cent liquid assets, and sometimes we would be obliged to sell our bonds at a loss of ten points, et cetera. We did not like that. That is the reason we prefer to go too far on the one side than be in trouble on the other side. That is our experience.

MR. TREMBLAY: It is a question of confidence. Our people are sure they can get their money back whenever they want so you see by the result the answer. We keep very much with loans and maybe would have less assets. It is a question of confidence. People with money do not like to put it somewhere where they feel they cannot get it back when they need it.

COMMISSIONER MacKEEN: In the period mentioned did you have abnormal withdrawals by depositors?

MR. TREMBLAY: In what period?

COMMISSIONER MacKEEN: 1939.

SENATOR VAILLANCOURT: 1959.

MR. TREMBLAY: 1939 it was the beginning of the war so at the time we did not know what was coming

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SENATOR VAILLANCOURT: 1959.

MR. TREMBLAY: 1959 it was the beginning [illegible]

so we felt that because of the unknown future --

COMMISSIONER MacKEEN: Well, 1939 was tight money too, but that was just on account of withdrawals at that time?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: You could not get an insurance policy against falling bond prices?

SENATOR VAILLANCOURT: No.

COMMISSIONER BROWN: You carry your own insurance for that by distributing the maturities, and I gather you have a suggested distribution of 10 per cent each year over a ten year basis, but again you are not able to follow this exactly?

SENATOR VAILLANCOURT: No.

COMMISSIONER BROWN: I notice you said it was very unusual to go beyond ten years, but on page 104 it shows that 7½ per cent are in this category. This is an example of 278 caisses and on the same page it shows that the centrals have 9.1 per cent beyond this ten year category.

SENATOR VAILLANCOURT: Yes, but you know some years ago in the province of Quebec the government took all the debts of the school board organizations in the province of Quebec and obliged us to change them for bonds for 20 years at low interest rates, et cetera, and we were obliged to take that.

MR. TREMBLAY: There was a forced conversion.

COMMISSIONER BROWN: This explains this.

MR. TREMBLAY: Yes, to a certain extent.

SENATOR VAILLANCOURT: And after that when we

buy some federal bonds sometimes we will take 15 or 20 years for the federal or province, but after that not after ten years.

COMMISSIONER BROWN: You refer to your policies having been based on previous experience?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER BROWN: Did that experience with school bonds make you a little cautious about buying school bonds?

SENATOR VAILLANCOURT: Oh yes. Now, ordinarily in school bonds we take only the parts guaranteed by the government. They guarantee these from one to five years, board bonds. We do not take longer than that, not guaranteed by the government.

COMMISSIONER BROWN: You mention that the experience in 1959 influenced you to keep a larger cash ratio?

SENATOR VAILLANCOURT: Not larger, but the contrary of that. We were forced by the circumstances of the situation, et cetera, to reduce our cash.

COMMISSIONER BROWN: You misunderstood me, Senator. I noticed from the statistics that before 1959 your cash was running around 7 per cent and 8 per cent and after 1959, after that experience, you raised it consciously or unconsciously to around 10 per cent?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER BROWN: Now, is this going to be just a temporary thing? Do you think you will gradually work down to about 8 per cent again?

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SENATOR VAILLANCOURT: I would say it has been

a temporary thing for the last ten years.

COMMISSIONER BROWN: No, this is only the last three years.

MR. TREMBLAY: What happens in a case like this, you must remember that we deal with 1,250 odd individual autonomous bodies. Now, there are local conditions which are quite different in the same province as big as the province of Quebec and what happened in 1959 was that only a few units were a little bit short of liquidity. Maybe they had been the ones receiving instructions to change their policies and to act differently, but maybe they thought they were smarter than the ones telling them what to do, and when they tasted the tight money period in 1959 they were converted and they had to because they would have closed their doors, so they started to raise their liquidity and they came up to the standard that now we have peace with them. So that might explain why in the graph you have a different line of percentage that seems to be on the higher trend, but the rest of the picture remains practically the same. There might be some adaptation as we go on to be more careful in one or two instances, but the trend is strong. The percentage of liquidity that we recommend is generally enough under normal circumstances to face any eventualities.

COMMISSIONER GIBSON: Senator Vaillancourt, I would like to ask just a few questions about the nature of your investment policy. Going back to one of the questions Mr. Brown asked, about the character

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of your investment portfolio and its maturities on pages 102, 103 and 104 of the original French brief, you give this information and you suggest a certain pattern for the portfolio and apparently this is the same pattern that was suggested for the central and the local.

COMMISSIONER VAILLANCOURT: Yes, that is according to the laws.

COMMISSIONER GIBSON: But in fact they differ quite a little. The central has more of what you would call marketable securities and the local has less.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: This is for liquidity reasons, I take it?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Now, the same thing is true when you come to look at the term of the securities. You suggest roughly 50 per cent under five years, 50 per cent over five years, but actually the locals and the centrals are more liquid than that?

MR. TREMBLAY: Central is more liquid, yes.

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MR. TREMBLAY: Central is more liquid.

Yes.

COMMISSIONER GIBSON: Even the local shows 71 per cent under five years.

SENATOR VAILLANCOURT: Yes, but you know that the central owns more federal bonds and you know that the federal or provincials, they only have one or two issues, ten years or twenty years, that is the reason and the government bonds are more -- the market is better than the other, that is the reason, and after that this same local caisse populaire borrow some money through their school board.

COMMISSIONER GIBSON: And that would be serial bonds?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Some are payable every year?

SENATOR VAILLANCOURT: Yes.

MR. TREMBLAY: There is another reason too, Mr. Gibson; in the central it has been said a little while ago that they have to keep a much higher proportion of cash on hand.

COMMISSIONER GIBSON: Yes.

MR. TREMBLAY: No ---

COMMISSIONER GIBSON: So the suggested maturity, it doesn't mean as much for the central as it does for the local; the central will be more liquid?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: Do the centrals do much trading in securities in the sense of trying to improve yields?

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SENATOR VAILLANCOURT: No.

COMMISSIONER GIBSON: You don't, for example, when you are able to take a Province of Quebec bond at a certain maturity and turn it into another one with similar maturity and better yield, you wouldn't do that?

SENATOR VAILLANCOURT: Generally, no, because we figure when we buy some bonds, and so on, this year we are glad to receive $10 million or $5 million, and so on, and it all is selected every year for the amount they are supposed to refund the money. We don't speak of that.

COMMISSIONER GIBSON: So that in this particular area you don't respond very actively to short-term market changes and the security prices?

SENATOR VAILLANCOURT: No.

COMMISSIONER GIBSON: And there would be very little if any trading, I take it, in the locals?

SENATOR VAILLANCOURT: Very little, but a lot in some of the centrals where they have large blocks.

MR. TREMBLAY: There may be switches in certain cases.

COMMISSIONER GIBSON: That is what I was thinking of, "switches" is a better word.

MR. TREMBLAY: But that will be rather rare.

COMMISSIONER GIBSON: Have you ever thought of doing more of this as a means of enhancing your economy?

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MR. TREMBLAY: What we have we hold

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Are you influenced in the locals in the amount of securities you hold by the comparison of interest rates between securities and what is being paid on loans at a given time?

MR. TREMBLAY: Yes, there would be an influence there. If you have a caisse populaire with only bonds in its portfolio and you have your loans which are necessarily at a high rate of interest, that will affect the revenues in the societies, and there are some societies of that type where people seem to be all on the rich side and there are no borrowers, or very little, and on the other hand you sometimes have the reverse situation, but there are plenty of demands for loans. Of course, that society will get a better revenue out of that money loanded to the members and as the bond revenue will be less, well, that will put them in a better position generally speaking to have a better revenue out of those operations.

COMMISSIONER GIBSON: If bond holdings were quite high would they push their loans a bit?

MR. TREMBLAY: Well, we never push the loans, we just let them come. We are not there to show the people how to get in debt; we are there to teach them

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COMMISSIONER GIBSON: So, your security holdings are based in part on how much of a need and demand there is for loans and mortgages in the area?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: If there is a large demand for these the security holdings will be smaller than otherwise, and vice versa?

MR. TREMBLAY: Right.

COMMISSIONER GIBSON: You are prevented by law from investing in other provincial and municipal securities than those with the Province of Quebec, is this correct?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: And do you find this restrictive; would you like to have broader investment powers?

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COMMISSIONER GIBSON: We have heard quite a few ---

SENATOR VAILLANCOURT: And we can't control that.

COMMISSIONER GIBSON: We have heard quite a few representatives of the financial world who would like to have their investment powers widened. You don't have such a feeling?

SENATOR VAILLANCOURT: No, not for us.

COMMISSIONER GIBSON: So, to sum up on your bond transactions, you basically buy bonds to keep them; you don't trade in them?

SENATOR VAILLANCOURT: No.

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You know, one caisse populaire had 40 persons in the bond issue in 10 years and we have said it is not good for you to take the other bonds and issuing them for one, two, three, four, five years, and so on, for the assets, and to receive the money every month, and so on, and they changed it.

COMMISSIONER GIBSON: Do you centralize your bond purchasing with the locals in the centrals to a degree?

SENATOR VAILLANCOURT: Ordinarly with our local caisse populaire they ask the central organizations to furnish the bonds.

COMMISSIONER GIBSON: Do you adivse on the purchase of bonds?

SENATOR VAILLANCOURT: We purchase the bonds from the dealers.

COMMISSIONER GIBSON: Yes.

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COMMISSIONER GIBSON: It is a common practice for the central to give advice to the local?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: In the sort of securities it ought to buy?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: And even to purchase them for them at times, I take it?

MR. TREMBLAY: And the sale would be done by the central.

SENATOR VAILLANCOURT: Because when new bonds arrive on the market every local caisse populaire can buy 10,000 or 5,000, and so on, but if the central arrived with half a million dollars at a better price, than we can sell to our members at a better price.

COMMISSIONER GIBSON: Well, the centrals would know many of the borrowers whose bonds they were purchasing very well, wouldn't they; they would have had a lot of experience with their securities?

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COMMISSIONER GIBSON: And particularly the municipalities. You must be one of the largest tenderers in the market for municipal bonds in Quebec, is this not true?

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COMMISSIONER GIBSON: Does this make the market for municipal bonds in Quebec particularly good, better than the rest of the country?

SENATOR VAILLANCOURT: I don't know, but I think this is a good thing. We receive the reports every day from the government on the situation on every municipality, and so on, and we study that; we review the market and we study the situation of these municipalities, the towns and the cities and the villages, and after that we say no or yes.

MR. TREMBLAY: What do you mean by good market but low yield?

COMMISSIONER GIBSON: Good prices for the sale of the bonds.

MR. TREMBLAY: Well, in our case we don't mind that because it will help to finance some local bodies. If we were in search of profit we might be interested in something else.

COMMISSIONER GIBSON: I don't know, but I suppose your standards would have an influence on many of the municipalities with whom you deal?

SENATOR VAILLANCOURT: Sometimes, yes, sure.

COMMISSIONER LEMAN: Commissioner Gibson was not suggesting this is a bad thing.

SENATOR VAILLANCOURT: Oh no.

COMMISSIONER BROWN: I was interested in this because most buyers usually say that they are paying too high a price.

THE CHAIRMAN: We will adjourn now for about

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10 minutes.

--- Recess

THE CHAIRMAN: We shall now resume.

COMMISSIONER GIBSON: Senator Vaillancourt, I would like to ask you one more question about the securities investment practice, and it is a question on the valuation of your investments as to how, if at all, it affects your investment policy. I take it that you value your investments both in the locals and the centrals at book value?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Now, when the book value is above the market value, does this mean that you are very loathe to sell these securities?

SENATOR VAILLANCOURT: That is for the reason that we don't speculate on our bonds, to sell and change, and so on; we fix the price on our books and we wait until the maturity of the bonds.

THE CHAIRMAN: We shall now resume.

COMMISSIONER GIBSON: [illegible] [illegible] [illegible] on the valuation of your investments as to how, if at all, it affects your investment policy. I take it that you value your investments both in the locals and [illegible]

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COMMISSIONER GIBSON: Is the accounting practice of always showing the securities at book value and not rating specific reserves against them when they go down?

SENATOR VAILLANCOURT: No.

COMMISSIONER GIBSON: This is another reason for not trading the bonds?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Turning to your lending business, a relatively small part of the assets of the caisse populaire are in personal loans; it is about 8 or 9 per cent?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Is there any trend here? Are you tending to increase this type of business?

SENATOR VAILLANCOURT: Yes, we try to increase that, but we do business only with our own members. We are not in the field at large, as our other organizations. As I have said before, the first thing for us is the moral guarantee, and if people come to borrow some money to go for a vacation -- you know the advertisement, "Go on vacation now and pay tomorrow" -- and we are afraid of that. We prefer to say, "Save this year and go on vacation next year."

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COMMISSIONER GIBSON: The average size of the loan is quite small, isn't it?

SENATOR VAILLANCOURT: They are between 100 and 500 on average.

COMMISSIONER GIBSON: And your medium interest rate is quite low too?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: It is around 7 per cent?

SENATOR VAILLANCOURT: 7 per cent, but ordinarily it is 6 per cent plus life insurance.

COMMISSIONER GIBSON: The 7 per cent medium figure includes the cost of insurance?

SENATOR VAILLANCOURT: Sometimes it includes that, and that is simple interest: 6 per cent, I suppose, for $100 over 12 months, but we charge interest and I suppose the borrowers are supposed to refund the loan in 12 months, and we give $100 to the borrowers.

COMMISSIONER GIBSON: This is a true interest rate?

SENATOR VAILLANCOURT: Yes, true interest, and after one month they refund $10 and we charge 6 per cent on $100 for one month, and the next month on $90; and at the end of the year, instead of paying 10 or 11 per cent you pay 6 per cent, and you pay $3.50 for one year for $100.

COMMISSIONER GIBSON: So your rates are really very competitive, aren't they?

SENATOR VAILLANCOURT: Yes.

MR. TREMBLAY: Mr. Gibson, I have something to add to this statement: In 1961 we did exactly

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MR. TREMBLAY: Mr. Gibson, I have something to add to this statement: In 1961 we did exactly

115 thousand personal loans for $152 million,but in the mortgage section there has been quite a bit of personal loans which have been booked as mortgages. They would be the consolidation of debts: We have a member comes along and he is loaded up with debts all over the place -- small loan companies, merchants, hospital bills and taxes, and instead of just making him another loan on which he will have to make some more instalments, which are already too heavy, we will take the whole thing and pay the other debts immediately, and we consolidate with the mortgage on his property. So, there are a lot of our personal loans that are really booked as mortgages in our statements.

COMMISSIONER GIBSON: The reason they are under mortgages is that you have taken the mortgage as a security?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: But it is really a personal loan?

MR. TREMBLAY: Yes, and there is another reason, and that is because there is a limit by each caisse populaire of $500 or $1,000 at the general meeting, and we can't go beyond that unless the member furnishes some kind of security, and a mortgage is an acceptable kind of security.

COMMISSIONER GIBSON: Would you have any idea what proportion of your mortgages might be loans of this character?

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estimate, but I would say it may be 5 per cent or 10 per cent -- maybe 15 per cent.

COMMISSIONER GIBSON: So it might actually double your personal loan figure?

MR. TREMBLAY: I think it would double at least the amount in money -- not in number.

COMMISSIONER BROWN: If it is a mortgage loan do you ask the purpose of the loan in the same way?

MR. TREMBLAY: The same way. Nobody can borrow unless he specifies the purpose.

COMMISSIONER BROWN: If he has borrowed for a foolish purpose elsewhere and wants to borrow on a mortgage to repay this foolish loan ...?

MR. TREMBLAY: It may be a pretty good way to satisfy his need and to teach him a proper lesson so that the next time he will know where to go to borrow and he will be willing to accept somebody else's criteria about the purpose of a loan. They are really checked by the credit commission and if they make a foolish move we try to educate them and talk them out of the expenditure if it is not necessary.

COMMISSIONER GIBSON: Do the by-laws of the individual caisses usually specify a $500 or $1,000 limit for an unsecured personal loan?

MR. TREMBLAY: It is not a by-law. It is a resolution of a general meeting. They may change every year.

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caisse.

COMMISSIONER GIBSON: Yes, and it is usually $500 or $1,000?

MR. TREMBLAY: Well, it is $500 when you organize a new caisse populaire, and as it gets bigger it is increased to$700 and $1,000. In certain cases it may be $2,000, but those instances are rare. In some cases there may be no maximum at all, but I only know of a couple of instances in the province.

COMMISSIONER LEMAN: Is there a formula? Is it based on a percentage of the total assets?

MR. TREMBLAY: It is a question of a local decision.

COMMISSIONER LEMAN: Does the federation have a suggested formula?

SENATOR VAILLANCOURT: No.

MR. CHARRON: It depends on the growth of the caisse populaire and the number of loans among members.

SENATOR VAILLANCOURT: It depends on the size of it.

MR. TREMBLAY: The size and needs and local conditions. It is like the size of a hat: It depends on the size of the head.

COMMISSIONER BROWN: On page 119 it would appear that there are 101 locals that do not lend on mortgage?

MR. TREMBLAY: Yes. They would be the small ones. In the by-laws we are obliged to make all the small loans first. We are not allowed to go into the

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COMMISSIONER BROWN: Statistics sometimes produce some extraordinary results, and I personally am curious about the one caisse populaire that loans money at 2½ per cent and has $27 out. How does this happen.

MR. TREMBLAY: That must be the residue of a former loan that has been made, maybe to a public body like a waterworks. It may be a kind of co-op society for waterworks in a small village, and at the time 2½ per cent in that locality might have been the rate. That may be the residue on a loan that has been on the books for 20 years.

COMMISSIONER BROWN: In that case this would be a caisse that has been operating for some time and would have other loans?

MR. TREMBLAY: Yes.

COMMISSIONER BROWN: So it would probably have other loans out at different rates?

MR. TREMBLAY: Yes, but in these cases it is probable you will find that the rates of the loans

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are 4 or 5 per cent. Our people are very conservative that way. In the locality I have in mind, it is rather small and they have over $1 million in the caisse populaire, and there are two branches of banks, and they seem to be loaded up with money and they don't know what to do with it, and they make loans at very low interest rates because there is no demand. They cannot loan outside the locality, so they make loans at 4 or 5 per cent.

COMMISSIONER BROWN: My point was, presumably, because of the statistics some of these will be appearing in various places, and we go back to an earlier question about different types of interest on the same types of loans in the same caisse. Would there be cases where this exists?

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MR. TREMBLAY: If my memory is good, this is the only caisse populaire and this is the only loan that is done there and that is the rate.

COMMISSIONER BROWN: It probably only relates to children?

MR. TREMBLAY: Yes.

COMMISSIONER BROWN: It looked like a good rate.

COMMISSIONER GIBSON: The centrals themselves make some personal loans?

SENATOR VAILLANCOURT: No.

COMMISSIONER GIBSON: What are the $3 million that show as loans that the centrals make?

MR. TREMBLAY: That will be to local societies. They cannot make personal loans.

COMMISSIONER GIBSON: The centrals cannot make loans to individuals at all?

MR. TREMBLAY: No, they are not allowed to.

COMMISSIONER GIBSON: If you take the consolidation table on page 154 and look at the total of loans for the local caisses and the central caisses, they are added together. Why does this not appear?

MR. TREMBLAY: Loans to local societies by the centrals are on notes. These are on notes with bonds as security.

COMMISSIONER GIBSON: So it appears on both sides of this?

MR. MORIN: On the consolidation side you are adding the loans that the central makes to the caisses populaires, less the loans of the local caisses

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populaires to the central. This is the figure that appears there.

COMMISSIONER GIBSON: Does that mean there are other loans that the central makes?

MR. MORIN: No. I am sorry, yes, it might appear as other loans.

MR. TREMBLAY: Instead of a bond issue it may be a straight loan to some kind of public body there, that would be considered as an investment in reality.

COMMISSIONER GIBSON: There would be no personal loans or anything like that included in this figure?

MR. TREMBLAY: No, never.

COMMISSIONER LEMAN: I understood that the officers of the locals cannot borrow from their local?

MR. TREMBLAY: The credit commission supervises this.

COMMISSIONER LEMAN: Where can they go to get loans?

SENATOR VAILLANCOURT: They change; the board of director changes with the members of the credit committee, and the credit committee go to the board of directors.

MR. TREMBLAY: They perhaps borrow from the banks or other finance organizations.

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SENATOR VAILLANCOURT: Voyez-vous, les membres de la Commission de crédit ne peuvent pas emprunter, pas plus que ceux du Comité de surveillance, afin de ne pas se favoriser eux-mêmes. Or, si cette situation se présente dans une petite localité ou il n'y a pas beaucoup de monde, le commissaire de crédit qui veut emprunter peut démissioner; il est alors remplacé par un membre du Comité de direction, et est par la suite nommé au Comité de direction. C'est de cette façon que l'on contourne la difficulté.

MR. TREMBLAY: Perhaps some of the wealthier members might make a personal loan to help an officer who is deprived of the right of borrowing. That has been seen to happen.

COMMISSIONER LEMAN: Does that tend to discourage some people from accepting a particular function?

SENATOR VAILLANCOURT: No, that is a protection, but if the law is changed so that a member of the credit commission or the supervisors can borrow money guaranteed by savings, that would be better. Supposing, for instance, that I am a member of the credit commission and have $1,000 in savings, and I said they could use that money because I have a note from a borrower of the caisse populaire to the extent of $100,000 guaranteed by a savings account, that would be all right.

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what that member has in the caisse populaire itself?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: That is a perfectly safe loan?

SENATOR VAILLANCOURT: Absolutely.

COMMISSIONER GIBSON: Do caisses populaires participate in some of the provincial government lending programs from time to time in order to help farmers and fishermen and so on? You do not participate in any of the federal programs, do you?

SENATOR VAILLANCOURT: No.

COMMISSIONER GIBSON: Do you participate in the farm improvement program or the National Housing Act?

SENATOR VAILLANCOURT: We asked the federal government for permission to so participate but it refused.

MR. TREMBLAY: We are not a bank.

SENATOR VAILLANCOURT: We are not a bank and we have a provincial charter. The federal government does business only with people with federal charters.

COMMISSIONER GIBSON: Apart from that point, which is a technical point, do you think you should be involved in these programs like farm improvement and National Housing Act, and so on? Would you like to be so involved?

SENATOR VAILLANCOURT: Not as far as I am concerned, because we already have plenty of requests for loans. We cannot furnish all the money

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that people want and ask for. We have now plenty of requests.

COMMISSIONER GIBSON: You have quite a lot of liquidity though, Senator.

SENATOR VAILLANCOURT: We cooperate in respect of housing loans.

COMMISSIONER BROWN: Do you lend money under the National Housing Act?

MR. TREMBLAY: No, in respect of family housing.

MR. CARON: We cooperate in respect of the family housing project.

SENATOR VAILLANCOURT: We cooperate with Central Mortgage organizations here, L'habitation familiale. In the past the provincial government was paying 3 per cent on loans in respect of new houses, and 3 per cent of the interest was a rebate. We do not have the same thing in respect of federal loans. Now the provincial government has changed the law and given the same 3 per cent in respect of federal loans for new houses and so on. We probably now will go along with the federal government because we have agreed with the federal government to lend some money for new houses any place in the country. In the past, because we did not receive the 3 per cent from the province in rebate we did not so participate. Now that the provincial government has agreed to allow that rebate, we shall participate. These loans are guaranteed to 90 per cent.

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are an approved lender under the National Housing Act?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: You are an approved lender?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: Is this in respect of local caisses or centrals?

SENATOR VAILLANCOURT: Local caisses.

MR. TREMBLAY: At first the provincial legislature forbid this interest rebate on any type of loan other than those made under provincial regulation, so there could be no marriage. There was pressure on our people to borrow from the caisses populaires and to get 6 per cent with a 3 per cent rebate which would give a net cost of 3 per cent on interest. This was obviously better than Central Mortgage in respect of which there was no 3 per cent rebate. This, of course, has changed because the two legislative regulations are the same now.

SENATOR VAILLANCOURT: There now exists the same regulation in respect of both the federal and provincial governments.

COMMISSIONER GIBSON: Do you think it would be desirable to be involved in these farm improvement and N.H.A. loan programs?

SENATOR VAILLANCOURT: Yes.

MR. CARON: Yes. We are now ready to participate.

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MR. CARON: In respect to the farm improvement plan, that is another thing, and the federal government refuses to allow us to participate in this at this time. We requested to be allowed to participate but the federal government has absolutely refused permission.

COMMISSIONER GIBSON: We are just trying to find out how you think about these things. Would you like to participate if the federal government extended the regulations?

SENATOR VAILLANCOURT: If we are allowed to participate in the same way as National Housing organizations we are ready to do so, but the federal government has refused permission.

THE CHAIRMAN: I suppose some of your loans are in point of fact for farm improvement?

SENATOR VAILLANCOURT: Yes.

THE CHAIRMAN: What difference would it make whether you made loans under the federal legislation or loans the way you do now?

SENATOR VAILLANCOURT: We agree in that regard but the federal government refuses to accept us.

THE CHAIRMAN: Would there be any difference from your point of view?

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COMMISSIONER GIBSON: In respect of the question of interest rates on loans, it is indicated in the brief that they change rather gradually. In other words they do not respond quickly to surpluses of cash or competition in marketing conditions, is that correct?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: Would the interest rates, for example, in a large caisse with lots of money in personal loans change more promptly following changes in credit conditions?

MR. TREMBLAY: It depends on the pattern of interest rate on loans in the books. If they have a lot of mortgages at a fairly low rate of interest, that being long term, they will not be able to benefit immediately from a higher rate of interest, even if they do change their interest rate on loans. It would take a little while before it would make any difference. It would be easier to make a change in the larger caisses because they have ways and means of doing this. However, in the smaller units the change will be gradual. It takes quite a while before a farmer or someone in a small locality understands that the rate of interest has gone up from 6 per cent to 7 per cent. One must be very sophisticated in order to make these individuals understand. It is the same money and it is the same loan, and this is their own business. If they are satisfied to lend at 6 per cent, that is the end of it. These people are rendering each other mutual services. We tell them that the rate

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of interest they are charging is too low and they say: "Yes, we know it is lower than somewhere else", but they do not do anything about it.

COMMISSIONER GIBSON: In other words, when you have a heavy demand for loans you do not ration that demand by raising the interest rate?

MR. TREMBLAY: Oh, no, never.

COMMISSIONER BROWN: Do you try to attract more money by raising the interest rate on deposits?

MR. TREMBLAY: It does not attract more money. There are a lot of caisses where the rate of interest is far below other institutions, and they still come back to it.

SENATOR VAILLANCOURT: Service is the principal thing involved.

COMMISSIONER GIBSON: In respect to the question of response to credit conditions and monetary conditions, you have quite an interesting chart at page 148, and another at page 150. You have a summary in the second chart showing a comparison between the monthly changes in deposits and the monthly changes in loans. This shows quite a close relationship, particularly in the second chart. The loans seem to follow drops in the deposits fairly quickly. I presume this is because there was less new money coming in so fewer loans were made; is that what it boils down to?

MR. TREMBLAY: It has to follow this because in these caisses the liquidity goes out first. The first thing they know is that they have to respond; they

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SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: This shows quite a rapid response.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: If a small caisse finds that the money is not coming in they cannot make as many loans, is that what they do?

MR. TREMBLAY: They stop the big loans first, and if they are still short they stop lending completely. Then they go out and get after the borrowers trying to collect the loans, and then they fall out of the bond market. If they lose too much money they then try to borrow from the centrals until the situation settles itself.

COMMISSIONER GIBSON: They ask the borrowing customers to wait for a month or two?

MR. TREMBLAY: Yes, they postpone requests.

COMMISSIONER GIBSON: Yes, it is all done through direct action like that and not through changing the incentives in respect of interest rates and that sort of thing?

MR. TREMBLAY: Yes.

COMMISSIONER GIBSON: This chart indicates that the figures are adjusted seasonally. Are these seasonal adjustments or do you run a moving average throughout?

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MR. MORIN: There are two moving averages.

COMMISSIONER GIBSON: You do not have a seasonal average?

MR. TREMBLAY: No. You see, there are fluctuations in December and August.

COMMISSIONER GIBSON: Yes, it looked that way.

MR. TREMBLAY: Yes, that situation exists there because we are not able to have a full moving average for twelve months.

COMMISSIONER BROWN: These are averages, so some credit unions will be borrowing much more than others. Is there any pattern in this regard? Do the ones in the cities have a tendency to fluctuate more than the ones in the country?

SENATOR VAILLANCOURT: In the country especially they fluctuate more than the others.

COMMISSIONER BROWN: The country ones vary more than the city ones?

SENATOR VAILLANCOURT: Yes, in the summertime and in the wintertime.

MR. TREMBLAY: If you consider a large city you will see that there are large industries and it is improbable, unless you have a major crisis, that there will be complete lack of employment. Whereas, in certain small towns where there is only one single industry, there might be a strike or a business recession in the particular line of business, let us say textiles, for instance, and that locality will be hit hard. That is, however, an accident within the whole pattern.. In

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COMMISSIONER GIBSON: I should like to ask one or two questions in respect of mortgages. You give very full information in regard to your mortgage practices so I have very few questions.

You have indicated earlier that when the credit union -- I am sorry, when a caisse populaire starts it does not make mortgage loans, but makes personal loans. However, as that populaire develops to a certain size of liquidity it commences in the mortgage business. I presume this is still the pattern, is it?

MR. TREMBLAY: That is the practice.

COMMISSIONER GIBSON: Yes, and is that trend toward more mortgage loans or less mortgage loans in proportion to the size of the caisse populaire?

MR. TREMBLAY: The trend may show in the figures as being toward more mortgage loans in the larger caisses populaires because of the size. If you have ten mortgage loans at $5,000 each and compare that to one larger mortgage loan it does not compare properly. I would not say there is a shift from one type of loan to another type. This follows a different pattern. The caisses make the smaller loans first. They have priority, and following that, if there is enough money left, they will enter the larger field.

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SENATOR VAILLANCOURT: Yes, as an example suppose we receive an application for a mortgage loan of $2,000 and we receive at the same time a demand from 20 people for $100 each. The note will be passed first and then the others.

COMMISSIONER GIBSON: But as the credit unions grow in size and have more funds to disburse they tend to make more mortgage loans and deal more with the larger needs of their members?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: And that is a trend you expect to continue?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: In the mortgage business do you make many mortgages on existing properties as opposed to new houses?

MR. TREMBLAY: Yes, there are quite a few of those. What is the proportion I do not know.

SENATOR VAILLANCOURT: I think it is a 50-50 thing roughly.

MR. TREMBLAY: I would say roughly 50-50. You see, that is not the point. It has no bearing at all on the decision of the board whether it is an old property or a new one. Oftentimes an old property has more value because it has been built better than the new ones and with better material and just because it is 20 or 25 years old, if it is in a good state of repair, it is just as good value as security as a new home. On the other hand, this is not the basic factor in accepting a loan. The basic

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factor is the moral credit of the individual. If he is a credit-worthy man we will accept the security no matter what is the type of building -- new or old.

COMMISSIONER GIBSON: Your mortgage loans are all individual loans; you do not make loans to builders so that where they are made it requires the same amount of work, you have to appraise it and do the various things anyway.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER GIBSON: I am sorry, you do give statistics on this, on page 192 you have some statistics. Do you make many mortgage loans outside the housing field?

MR. TREMBLAY: On page 193 you have an analysis here of utilization of the loans by class of borrowers and (b) at the top is for the purchase of real estate which would be lands and buildings and it would be mostly housing and in (c) it is for repairs of buildings and other purposes. This "other purposes" might cover some of the things I said a little while ago -- consolidation of debts and the like, but it would be mostly for housing purposes.

COMMISSIONER GIBSON: You would not make loans for building an apartment or a commercial building and that sort of thing?

MR. TREMBLAY: There may have been a few for very small apartment buildings or for two tenants. It is permitted by the provincial law to allow to provide houses with a tenant but not for a big project.

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On page 191 you have the designations of different kinds of borrowers. What is the one "aux autres entreprises"?

MR. TREMBLAY: It would be other than farmers, fishermen, co-op societies.

COMMISSIONER BROWN: What does that cover because these are averaging $4,000 alone?

MR. MORIN: This classification was asked by the provincial government.

MR. TREMBLAY: This classification is the result of negotiations between the Bank of Canada, Central Mortgage and Housing Corporation and the Federal Department of Statistics and the Provincial Department of Statistics, in order to have a report in such a form that it will be comparable with the counterparts in other provinces.

MR. MORIN: They were interested in statistics about farmers and fishermen and co-op societies.

COMMISSIONER BROWN: What are these others?

MR. MORIN: It is other members in cities and all other members except fishermen and farmers.

COMMISSIONER BROWN: What are these -- small businesses?

MR. TREMBLAY: No, not small businesses, the workers in the cities and workers in the rural areas are all other members.

COMMISSIONER BROWN: I am not talking about the one on other members, but the one on other enterprises?

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COMMISSIONER BROWN: I am not talking about the one on other members, but the one on other enterprises?

MR. TREMBLAY: It may be a school board, municipalities, the church.

COMMISSIONER BROWN: These are bank loans.

MR. MORIN: In this case they are bank loans, yes.

MR. TREMBLAY: Local bodies and institutions.

MR. MORIN: They are probably responsible for a big part of the loans over $5,000.

COMMISSIONER BROWN: It is the number of them that is rather surprising. It is 2,000 which is an average of about two per caisse.

MR. TREMBLAY: That is not abnormal. In a single caisse we may have 50 or 60 of those local institutions. There will be different communities of teachers, male and female, you have hospitals, you may have nuns, brothers, parish priests, you may have all kinds of things. Take in the city of Quebec, for instance, where it is a converging centre, there are all kinds of things -- playgrounds for children, summer camps and things of that kind which are run partly by the church and local bodies. We finance all those things.

COMMISSIONER BROWN: These are unsecured loans?

MR. TREMBLAY: Generally.

COMMISSIONER BROWN: Thank you.

COMMISSIONER MACKINTOSH: Senator Vaillancourt, I would like to ask one or two questions about deposits. I notice from the figures, at least some figures I have here, that the turnover in your deposits is a bit higher

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than ordinary savings deposits in the chartered banks but, of course, very much lower than current deposits in the chartered banks, the rate at which they turn over. Are these savings accounts in the caisse populaire usually the only chequing accounts that a family maintains?

SENATOR VAILLANCOURT: Now you pay all by cheque, gasoline and store, et cetera.

COMMISSIONER MACKINTOSH: You mean this is becoming the custom?

SENATOR VAILLANCOURT: Yes.

MR. MORIN: On page 141 we have the number of cheques drawn on the caisses populaires, the number and the amount and there is $1,269,000,000 of chequing account that was passed by cheque. This is around 75 per cent of the withdrawals in the caisses populaires this year.

COMMISSIONER MACKINTOSH: There was some discussion a few moments ago about the year 1959. I notice that your deposits rose less in that year than in any other and I gather from the chart that in the last quarter of the year they actually decreased.

SENATOR VAILLANCOURT: In 1956?

COMMISSIONER MACKINTOSH: In 1959.

SENATOR VAILLANCOURT: Oh yes.

COMMISSIONER MACKINTOSH: I wonder if you would care to say a little more about the experience, why the decrease in the deposits?

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MR. MORIN: If we are not answering to a change in interest rate our members are.

COMMISSIONER MACKINTOSH: In other words, in a period of high interest rates they have more attractive things to do with their money than deposit it with you?

SENATOR VAILLANCOURT: Yes, that is true.

MR. TREMBLAY: As soon as the ordinary loaning institutions ceased to make loans or even stopped loaning well, what do you think we can do? There is less money in circulation and deposits decrease instantly. We have no control over that. Some other institution has a perfect control of increasing the volume of money in circulation.

COMMISSIONER MACKINTOSH: Did you attempt to combat this by raising your own interest rates at all?

MR. TREMBLAY: No.

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COMMISSIONER MACKINTOSH: It being true that your organizations do not respond to changes in the interest rate, this indicates that your members do, that the alternative opportunities do affect the flow of deposits and therefore the money that you have to lend?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER MACKINTOSH: Would any of your caisses respond differently? I mean a large urban caisse with possibly a more sophisticated management, would they act differently from the ones which have been described a while ago in a remote part of the country?

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COMMISSIONER MACKINTOSH: Well, that is exactly what the trust companies and I think the insurance companies told us about their business, that they had these commitments ahead that they had to meet.

I was interested in your requirements in regard to shares. There is an entrance fee payable when the share is purchased, an entry fee.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER MACKINTOSH: Does that act as a restriction on the purchaser's shares?

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COMMISSIONER MACKINTOSH: What is the reason

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SENATOR VAILLANCOURT: At the beginning when the local caisses populaires started I suppose we permitted ten people to take 1,000 or 2,000 shares and the balance of the locality, that is, only labouring people and farmers, et cetera, they took only one share, two shares, et cetera. But after one year the ten shareholders of 2,000 each said: "We want such and such a board of directors, Mr. so and so. If you do not agree with us we will pick up our money." The situation would be terrible for the caisses populaires. That is the reason why at the beginning we permitted 100 or 200 shares, not more, and after that we increase according to the size of the caisse populaire to prevent control by anybody. That is the reason.

COMMISSIONER MACKINTOSH: Well, the entry fee which is not returnable is something in addition to this.

SENATOR VAILLANCOURT: Yes. You know, the shares are supposed to stay there and if and when we charge a fee that is the people who lose.

COMMISSIONER MACKINTOSH: It acts as a penalty against withdrawing?

SENATOR VAILLANCOURT: That is a kind of stabilization fund.

MR. TREMBLAY: That is one of the outlets to build up the reserve fund. Some people say: "Well, you have big reserves, they are not taxed". Well, it belongs partly to the members, it is money they paid

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to get in and it goes directly to the reserve fund.

There is another reason that entrance fees go up. In some cases it may be 20 cents, 40 cents and even 50 cents. We have seen instances where the entrance fee for $5 shares would be $1 and actually I do not know of any that would be over 50 cents I do not believe. There are a few at 20 cents or 25 cents, not for the first share but for the first 50 or 100 shares the entry fee will be left at 10 cents so the small people will come in, but the reason for the increase of that entrance fee is to force the new member that comes in to participate somewhat in the same proportion as the older members who have contributed to the building up of the big reserve.

Being admitted as a member in a co-op society he becomes a co-owner of the enterprise and is entitled to a share of the profit deriving from that source. There is a book reserve and the chances are they will get a higher bonus and get a high rate of interest on their deposits, so then we increase the entrance fee as we go along and that acts as a brake, too.

COMMISSIONER MACKINTOSH: It is roughly what the banks do in a more elaborate way when they issue more shares; you have to pay your share of the capital and also your share of the reserve?

MR. TREMBLAY: Yes.

COMMISSIONER MACKINTOSH: At the annual meeting of the local caisses populaires, did you say it was one share and one vote for each one man?

SENATOR VAILLANCOURT: No, one man one vote.

MR. MORIN: We would like to mention there is no special plan to share in the chartered bank.

COMMISSIONER MACKINTOSH: You said a while you don't go out and solicit loan business?

SENATOR VAILLANCOURT: No.

COMMISSIONER MACKINTOSH: But you do to a considerable extent carry on education in favour of deposits?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER MACKINTOSH: You do active solicitation?

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want to get married and have no money and they come to caisse popularies and say, "We want $2,000 to buy some furniture," and so on and so on, and that is a very, very bad education.

The young peoples spend all their money outside for many thing, foolish thing and so on, and we educate the young peoples. You know, it is not good business, maybe, but I think we will do something for the nation.

Your know when the young peoples are out to school at 8 or 10 years and he receive from his father 25 cents or $1.00, and so on, and if these young people go to the store and spend for ice-cream they have done some foolish thing with that, but if we can educate -- I don't say 100 per cent, but only 5 per cent of the young peoples to save their money it would be a very good thing.

You know, the principle is this: These young peoples or this young girl control herself by herself, and tomorrow if we want something for the education, to buy some good books for during a vacation, and so on, I have the money to pay that, but the first thing to be applied is to control himself and when we arrive at 20 years after that and we are doing that for 10 or 12 years and we arrive -- I have to control myself even if I can't control many things.

COMMISSIONER MACKINTOSH: You and I understand this but I am not sure of my colleagues!

COMMISSIONER LEMAN: Perhaps we should all empty our pockets!

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COMMISSIONER MACKINTOSH: It wasn't clear from reading your brief as tojust what your arrangements are for clearings. Have you any clearing system, clearing arrangements within your own system?

SENATOR VAILLANCOURT: Yes, we have a clearing system. You know, our organization is divided up into to 10 regional organizations but we have two central organizations for clearing. One is in Montreal and one in Quebec and we have passed an agreement with the Banque Provinciale that all the cheques coming from the caisse populaire go to -- collected from the bank go to the Banque Provinciale.

COMMISSIONER MACKINTOSH: Do they go through two centres first?

SENATOR VAILLANCOURT: No, they go first to the Banque Provinciale and after that the Banque Provinciale distributes between Montreal and Quebec for clearing, and we do the same with the bank cheques and the bank cheques received we send to the Banque Provinciale and the Banque Provinciale distributes it to the banks.

COMMISSIONER LEMAN: Your centrals don't play any part in this system?

SENATOR VAILLANCOURT: For the clearing with the banks we have two centres except, I suppose, in Three Rivers or Sherbrooke, for the local banks and the organization there is that it is directly with the bank, and so on, but at large in the Province of Quebec or any place in Canada we have two large centres, Quebec and Montreal, and after that we distribute

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to our regional organizations and the regionals distribute to the locals.

COMMISSIONER BROWN: But about clearing between one credit union local and another credit union local; is that done through the central?

SENATOR VAILLANCOURT: No, they can't exchange in the same place, in the same locality.

COMMISSIONER BROWN: Not necessarily.

SENATOR VAILLANCOURT: No, they send to the regional organization.

MR. TREMBLAY: All outside items are deposited in the central, what are drawn on another caisse, an outside caisse or a bank and it is cleared through the centrals.

COMMISSIONER BROWN: You have your own internal clearing system for your own internal items?

MR. TREMBLAY: Yes, we have 10 offices.

COMMISSIONER LEMAN: Is this all free or is there a system of charges between them?

MR. TREMBLAY: There is no charge except the ordinary charges for exchange from an outside point. It is an absolutely free service of the movement; we charge what it costs us. If we pay exchange to other institutions, well, that is charged to whoever got the service.

COMMISSIONER MACKINTOSH: But within the system; take a cheque, we will say, of a local in Three Rivers which is deposited with another local in Chicoutimi, do you charge an out of town fee on it?

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COMMISSIONER MACKINTOSH: Is this system satisfactory; does it meet all your needs?

SENATOR VAILLANCOURT: It is worth its value.

MR. TREMBLAY: It is a good bit expensive.

COMMISSIONER MACKINTOSH: You say it is expensive only in the sense that you would be pleased if it were done for less or that you think it is unreasonably high?

MR. TREMBLAY: In that field we have an agreement and we are completely satisfied with it; the only thing is we feel when we render the service this is a reciprocating service, and the area institutions render us this service, and the rates may be the same.

COMMISSIONER MACKINTOSH: What is this reciprocal service that you render and what is the difference in rates?

MR. TREMBLAY: Well, you have before you that clearing in the brief from the C.C.S. and you will see the difference there. When we process a cheque drawn on a bank we have to pay 5 cents on each item and a certain rate of commission, and on the reverse when it is drawn on us and processed, we have to pay another 5 cents and we don't have the same rate in return, and that is quite a difference. We pay both ways.

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MR. TREMBLAY: And if we don't perform that clearing on the cheques drawn on the banks -- you see, only for federal government cheques we had 3,216,000 cheques in 1959 and 1960 for $118 million; that would be for family allowances, old age pension and other things, that have been cleared through our caisse populaire in at least 400 places where there are no banking facilities, so in certain cases we have to pay out too much cash and do somebody else's business.

COMMISSIONER MACKINTOSH: Are you required by law to clear these federal government cheques at par?

SENATOR VAILLANCOURT: We are not required by law but we do it because we know the people are obliged to cash the old age pension cheques, and so on, and have to go 40 or 60 miles or more than that to get their money.

MR. TREMBLAY: The deposits of these institutions, both provincial and federal, is the same thing; we would have the same thing for provincial cheques. Deposits are made in the banks and we have to process the cheques and make nice packages, parcels all wrapped up, and if we make an error in the parcel we have to pay $1 fine besides that.

COMMISSIONER MacKEEN: But you only provide that service for your own members?

MR. TREMBLAY: We are not allowed to do business with somebody else.

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COMMISSIONER LEMAN: Suppose I am a tourist and I have a travellers cheque, can I cash it in at the caisse populaire?

SENATOR VAILLANCOURT: Yes.

MR. TREMBLAY: We have no money because they want it exchanged, but in a big office you can do it.

SENATOR VAILLANCOURT: If the owner of the travellers cheques is a member of our organization, but not if he is out of the organization.

MR. TREMBLAY: We have had bad experiences with this non-member business and even with your presumably members of another caisse populaire. Somebody comes along and is a crook and forges a document and tries to give a nice story to the local manager, and they come with all kinds of things, travellers cheques and we had some from the Bank of Montreal about a year ago that were on forged documents.

COMMISSIONER MACKINTOSH: This wasn't contemplated in that sense.

MR. TREMBLAY: But we have learned a lesson just the same not to do business with people we don't know and we strictly adhere to do business with our members; they are known, we know who they are.

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COMMISSIONER LEMAN: If a member, for instance, wanted to buy U.S. funds for a trip or for some reason, would you be able to handle it?

MR. TREMBLAY: It is in the convention schedule we have with the banks; we can get the foreign money through the bank according to certain conditions that are stated in that convention, but it is very negligible to the operation.

COMMISSIONER LEMAN: I was wondering if in the large centres like Montreal ---

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COMMISSIONER LEMAN: Well, I would like to ask you a fairly simple question about the trend of your earnings and expenses, and I am looking mostly at the series of statements you have given us for various years on pages 183, 184, 185 and 186.

It seems as though both as a percentage of the assets in your system as well as a percentage of the earnings of the system, both earnings on loans and earnings on investments, the administrative costs tend to go up by about 1 per cent both ways as a percentage of assets to gross income. Why do you believe this trend is going on; why does it get more and more extensive in relation to the total volume done? One might expect with volume that the percentage

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MR. TREMBLAY: Well, the main reason for that is when you move from a small society that is kept in the kitchen of the manager or in a room of his home and you get a little bit bigger -- well, they need an office, they need a vault, they need a space, they need an adding machine and typewriters and all the equipment, and eventually they will need time locks and other security gadgets, so that is one thing.

Then, as you increase, well, you need further protection and insurance of all kinds. You need more help. At the beginning of the society when it is small, well, for the first year the managers don't have a single cent of salary, they are hired for $1 a year just to say that they have something and they cannot make a claim against the cash book later on, and it may take years before they get any type of worthwhile salary, but if they get to a certain point, not only is it a fulltime job for the treasurer, but they need hired help, and that would explain for this switch. You have the new vaults, the burglar proof valuts and different gadgets of this type with the time lock devices and everything that is necessary. Well, we run into money.

SENATOR VAILLANCOURT: Over the last five years we have more than doubled and tripled expenses on that.

MR. TREMBLAY: And then armed guards; protective protection.

COMMISSIONER LEMAN: Do some locals have that?

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COMMISSIONER LAMAN: Do some locals have that?

MR. TREMBLAY: Over 100 locals have armed guards full-time, and we have a fine staff, which is quite important besides that, and it is quite useful; it is strictly on this police work.

COMMISSIONER LEMAN: But this is in the central, isn't it?

MR. TREMBLAY: No, no; the locals are paying for it. We can't do a miracle; we have to charge for the services we render.

COMMISSIONER LEMAN: Well, besides all these frills that you need as time goes on, what has been the trend of salaries for the paid personnel in the caisse populaire; I suppose it depends on the size of the cash books. What is the general level of salaries to managers?

SENATOR VAILLANCOURT: The salary is not fixed according to the assets of the caisse populaire. We discuss it freely with the manager, that we have such and such revenue and we can pay him so much: that is all. At the beginning we have not fixed it, in the past, to 1 per cent of the total assets, but now we can fix that.

MR. TREMBLAY: There has been an increase in the cost of living and an increase in the salary scales, and of course I am speaking of full-time employees, and ours are not underpaid because we very seldom see somebody working for caisse populaire moving to some other institution.

COMMISSIONER LEMAN: You seldom see that?

MR. TREMBLAY: Very seldom. We keep on hiring quite a few outside people, and they seem to be satisfied with what they get salary-wise.

COMMISSIONER LEMAN: In general you have been able to retain your trained personnel in the system?

MR. TREMBLAY: Yes.

COMMISSIONER LEMAN: Are there educational requirements for the manager? What would you say would be the minimum qualification for a manager?

MR. TREMBLAY: It is quite hard to answer for all the caisses populaires. Generally speaking I would be inclined to think that the majority of the new managers come from the ranks. They start as an employee and grow up with the society, and when there is a change, if he is assistant manager and he is a good man, and he is known and belongs to the

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society, he will be promoted to the job of manager.

COMMISSIONER MACKINTOSH: This practically makes it a bank.

MR. TREMBLAY: Yes.

COMMISSIONER LEMAN: The banks traditionally train their personnel.

MR. TREMBLAY: Yes. We have to do that in the larger offices. In some caisses we are up to over 20 people in one office.

COMMISSIONER BROWN: Will there be much movement between caisses?

MR. TREMBLAY: Very little. There will be some if a local society is under-staffed for one reason or another -- an accident or sickness. They may get in touch with the regional unit or the federation and ask for help, and there may be some exchanges like that, but it is nothing like the transfers there is in the banks, for instance, which are organized in that way.

COMMISSIONER GIBSON: If a man does particularly well in a small caisse, is a larger one likely to come along and hire him as manager?

MR. TREMBLAY: It is possible, and often we go and pick him up for our department -- supervision. If we spot a good man, and he is willing to go further in life and do more work and earn more money, we will do that, if by hiring this man we do not disrupt the smooth operation of the local society. If they were without a replacement, we would not take him. If he can be replaced without harm to the society we

society, he will be promoted to the job of manager.

COMMISSIONER MACKINTOSH: This practically makes it a bank.

MR. TREMBLAY: Yes.

COMMISSIONER [illegible]: The banks practically train their personnel.

MR. TREMBLAY: Yes. We have to do that in the larger offices. In some caisses we are up to over 20 people in one office.

COMMISSIONER BROWN: Will there be much movement between caisses?

MR. TREMBLAY: Very little. There will be some if a local society is under-staffed for one reason or another -- an accident or sickness. They may get in touch with the regional unit or the federation and ask for help, and there may be some exchanges like that, but it is nothing like the transfers there is in the banks, for instance, which are organized in that way.

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will give him a chance.

COMMISSIONER LEMAN: It is a system of promotion?

MR. TREMBLAY: Yes.

COMMISSIONER LEMAN: Senator Vaillancourt, one thing that is, I would say, one of the most striking characteristics of your brief, besides being complete and representing a lot of work in informing this Commission about what your system is, is the fact that you do not ask us for anything. Everyone who has been before us has asked us for something. They were complaining about something in the financial market, the way it works in Canada; sometimes they were complaining about the fact that other institutions were invading their field and making life tough for them. You seem to think everything is going pretty well in Canada and there is nothing much wrong with it. Would you mind giving us a few opinions on matters of general interest. First of all, you did mention during the course of our discussion this morning that there were a few things on which you thought that provincial law could bring about some improvements. You mentioned that there are certain additional powers that the federation would like to have for good control of the whole system.

SENATOR VAILLANCOURT: Yes.

COMMISSIONER LEMAN: Then you did mention one thing that was a detail -- this right for units to grant loans to credit offices as long as they are secured by savings in the system. Are there any

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COMMISSIONER LEMAN: Then you did mention one thing that was a detail -- this right for units to grant loans to credit offices as long as they are secured by savings in the system. Are there any

other things of importance that you would feel the provincial law could well stand to be improved?

SENATOR VAILLANCOURT: You have many people come here to ask for so many things, I think for us it is not necessary to ask. If the new law in the Province of Quebec is approved, I think we will be satisfied with that, because, you know, we are not in the market for increasing the loans, and so on and so on. It is a funny thing, probably, but that is our idea. The first thing in our organization is education and services, and the principle is not to increase our revenue and so on and increase the loans for anything. If you have heard in the television for the last four years our programme is an education programme. There are the programmes Joindre les deux Bouts and Droit de Cite, and our programme is an educative programme.

The situation is now forming for many people who think only of money, money, money, and trying to increase the loans and interests, and so on. I think this is not a good thing for the world. It will be necessary to come back and live according to our revenue and work for that; don't receive anything for nothing. You can't buy a press and print money for nothing. It is absolutely rediculous and we should organize more education every place in our country and in the world. When I see on the television, TCA which is a government organization advertising, "Go to Europe for $42 and pay next year", it is ridiculous to us. I asked a friend of mine last year,

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"Where are you going this summer for your vacation?" He said, "I will be staying in my own kitchen." I said, "For what reason?" He replied, "I am obliged to pay for last year's vacation this year." It would be better to save this year and go next year. There are some people who think this argument is ridiculous, but I think it is ridiculous to go where we are going now -- spend, spend, spend. And after that, what?

I would mention one other thing, because so many people appearing before you have said the caisse populaire don't pay any income tax. The answer is very simple: All our board of directors, commissioners of credit, and supervisors, work for no money -- not for nothing; but they work for their neighbours and their friends and for the members of the society, and they are ready to do that, and if the government taxed the caisse populaire they would be taxing these people. If the government changed it, the board of directors and the other members of the other boards would be asked to receive a salary, and after that the government wouldn't receive very much more, because all our savers in our organization receiving $100 or more on shares and savings are shown on a report which we file with the federal government, and every individual pays his taxes on that.

We have no other arguments, and I don't like to say too much.

This is another thing when we discussed the shares a few minutes ago. In the caisse populiare at Levis, the oldest caisse populaire, we have a

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reserve of $600,000, and if a group of new members arrives and says, "We will stop the caisse populaire; close the door, and we will distribute the reserve funds", it is prohibited by law -- not by our rules, but by the law. If a caisse populaire closes with a reserve fund, this reserve fund is obliged to be distributed to a special charity designated by the Governor-in-Council.

That is another thing to be borne in mind when people say we have a big reserve; the big reserve is only to protect our own members, and not for themselves. Another thing, we have some big organizations with big secret reserves who are not paying any tax on that, and if the government agrees to change that, I will be obliged to agree on everything, but I think it would be preferable if you want to educate our people to working for something and working in the future for their neighbours freely; not for nothing, but freely, to help people. I think it would be better to stay as we are.

COMMISSIONER LEMAN: You also mentioned a few things in the federal field. You said you had applied for particiaption in various federal programs on which you had been refused participation, but you did not choose to make any recommendations to this Commission on these matters.

SENATOR VAILLANCOURT: If the government agrees with us on the mortgages, like the Central Mortgage and Housing have farm loans, and if they permit us the same conditions as the banks, it would be a good thing to help the farmer.

COMMISSIONER LEMAN: You did not choose to make any recommendations on matters of general interest either about the way the Bank of Canada works?

SENATOR VAILLANCOURT: No. After our explanation, I think you are very clever men and you can recommend what is necessary.

COMMISSIONER BROWN: You are quite a large and

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COMMISSIONER BROWN: You are quite a large and

important sector of the banking system in Quebec, whether you call yourselves a savings bank or not; in effect, you operate the same as the other savings banks. Have you any comments about the banking system, about the 6 per cent interest rate?

SENATOR VAILLANCOURT: Oh, that is another thing. If we recommend to increase the interest, I think it will not be very good for the prevention of inflation. You know in all the organizations -- savings and trusts and so on -- the loans sometimes are very, very high. I think it would be better to control the other organizations than the banks to increase the interest. Many, many millions of people are going into financial organizations and borrowing money at 24, 48 and sometimes more than 100 per cent interest. I think it would be a good thing if it is possible to control that, and we agree on that. But if we permit the financial organizations, banks and others, to increase the interest rate to 7 per cent or 8 per cent, I think it would not be good for the control of inflation. It would be quite the contrary.

COMMISSIONER BROWN: There is no control on the rates you can charge.

SENATOR VAILLANCOURT: Control on interest charges, yes.

COMMISSIONER BROWN: What is the control on the rates you can charge?

SENATOR VAILLANCOURT: No, we have no real control, but with the spirit of our organization we advise our people not to go too far. We have one caisse

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with 8 per cent, but I think the average is 6 per cent. In 99 per cent of the caisses it is 6 per cent.

COMMISSIONER BROWN: You have 36 that charge 8 per cent and more?

SENATOR VAILLANCOURT: Yes, but on mortgages, 8 per cent ----

COMMISSIONER BROWN: I am talking about other loans.

SENATOR VAILLANCOURT: On the notes -- not on mortgage, no; mortgage, not more than 6 per cent.

COMMISSIONER BROWN: Do you think banks should be controlled to 6 per cent?

SENATOR VAILLANCOURT: Yes.

COMMISSIONER BROWN: But not the caisse populaire?

SENATOR VAILLANCOURT: Not the caisse populaire. We control ourselves.

MR. CHARRON: The Co-operative Credit Society belongs to the members, and the members would not be interested in paying a high interest rate. The control is automatic.

COMMISSIONER BROWN: I agree with that, but I am asking about the philosophy which says that banks should be held to 6 per cent, but you have 36 caisses that charge 8 per cent and more.

SENATOR VAILLANCOURT: Not more.

COMMISSIONER BROWN: You have 35 that charge 8 per cent and one that charges 9 per cent; so, you have 36 that charge 8 per cent or more. Why should the others be held down?

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COMMISSIONER BROWN: [illegible]

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COMMISSIONER BROWN: You have 35 that charge 8 per cent and one that charges 9 per cent; so, you have 36 that charge 8 per cent or more. Why should the scheme be [illegible]?

MR. TREMBLAY: First of all there is a difference in the calculation. We have put in the brief how we calculate the interest. It is not a discount interest. It is a straight interest. If I borrow $100 and I have to pay a $6 interest to start with, I only get $94 and I begin to make my repayments ---

COMMISSIONER BROWN: But there are other institutions which only charge simple interest. Let us not confuse the issue.

MR. TREMBLAY: Yes, and we do not have the multiplication factor to work on. We are simply a financial institution, not a monetary institution. That is a big factor. This might have been one of the reasons why these people put the ceiling in the Bank Act at that level. I do not know, but I feel they must have had pretty good reason for it. I would be very interested to know why they did that if it is not because of the multiplication factor which gives to certain institutions an advantage which none of the others have.

COMMISSIONER BROWN: I think there is a confusion here resulting from referring to this as a multiplication factor. When you look at it the other way, you keep your people at 10 per cent cash and the chartered banks are kept at 8 per cent cash. Do not look at it as a multiplication factor, look at it as a cash reserve. I think you are looking at it in the wrong way.

MR. BOYER: In respect of all these rates you must include the loan insurance. All those rates to which you made reference have loan insurance charges included in them.

COMMISSIONER BROWN: I just wanted to find out your feeling as to whether you thought the 6 per cent ceiling should be less for the banks.

SENATOR VAILLANCOURT: I would be ready to accept the same thing for the caisses populaires, and I refer to the 6 per cent. We have no objection to that.

THE CHAIRMAN: We are very much obliged to you,

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Senator Vaillancourt and gentlemen. The discussion has been very useful and interesting. I think we have all learned a great deal as a result of this session with your organization, and we wish to thank you very much for your presence here today and for the assistance which you have given us. We have asked many questions, some of which have been provocative. We will give the fullest consideration possible to your views. I might say that we are all very much impressed with the great work that your institutions has been doing. Thank you very much.

SENATOR VAILLANCOURT: Thank you very much Mr. President and Commissioners. I hope you will do the best for our country, as I am sure you will.

THE CHAIRMAN: We shall now adjourn until tomorrow at 9.15 A.M.

--- Adjournment.

2.

Royal Commission on Banking and Finance

La Federation de Quebec des Unions Regionales
des
Caisses Populaires Desjardins

Hearings held at

Ottawa

Vol. 26A

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Toronto, Ont.

S E C T I O N   I

HISTORY AND PHILOSOPHY OF THE

CAISSES POPULAIRES DESJARDINS MOVEMENT

[illegible]

[illegible]

[illegible]

[illegible]

1. THE EMERGENCE OF THE "CAISSES POPULAIRES DESJARDINS"

In the not too distant past, the Canadian population was largely rural in character. Living on agriculture and handicrafts, families were self-sufficient. They produced the food and clothing and other commodities which they needed. Trade was rather restricted, as there was virtually no market. In our rural parishes, almost every craft flourished, providing families with all their needs. It was a domestic economy.

But times have changed. Great inventions (such as the steam engine, which revolutionized industry) introduced a new economic era by making it possible to organize transportation, manufacturing and marketing on a massive scale. One of the effects of the economic revolution was to concentrate the people around large production centres; large modern cities (with all their social problems) began to mushroom.

Old economic formulae broke down under the impact of the industrial and commercial boom, giving way to a new economy which has been described as capitalist. The nascent large-scale industry had a great need for capital. This need brought about the famous development of the capital stock corporation, whose great appeal was its capacity to attract savings through the distribution of profits on capital. The capitalist system, based on purchasing and selling at a profit, quickly expanded with the tremendous production boom, bringing about

a proliferation of intermediaries dependent on production, and stimulating economic and financial concentration through the distribution of profits on capital.

Farmers and craftsmen were forced to adjust to the new economic conditions and began producing for the market. Agriculture became an industry, then a business. Agricultural families increasingly looked to the market to supply their needs, selling farm products at wholesale prices and purchasing needed commodities at retail prices. The marketing and selling of agricultural products and the distribution of goods have become costly. Farmers by no means always get a fair price for their products. They do not receive a fair share of the national income. For too many agricultural products, there is in some cases a considerable spread between the price paid to the farmer and the price paid by the consumer. In 1935, the report of the Stevens Royal Commission on prices in Canada cast some light on unfair business practices and the high cost of distribution and recommended, among other remedial measures, the promotion of distributors' co-operatives.

To protect themselves from the inroads of a capitalist economy, families and farms had only one effective means at their disposal: to unite on the professional and economic level, i.e. to integrate into the economic life through the development of co-operatives which would enable them to become

[illegible]

[illegible]

to the [illegible] economic conditions and other prevailing [illegible]

[illegible]

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their own bankers and dealers, eliminate costly middlemen, secure a better price for their products, purchase goods of professional or other use at a cheaper price, and enjoy a fairer share of the national income.

Mr. Leland Olds, one of the six members of the committee appointed by President F. D. Roosevelt in 1937 to investigate the co-operative movement in Europe, noted in the committee's report on modern co-operation and its economic impact:

> " The co-operative system is not quite new, though its application to modern production and marketing techniques belongs to our time: the self-sufficient rural family, before the industrial revolution, was essentially a co-operative organization; the elements of the local and regional co-operative association existed in the Middle Ages. But the industrial revolution gradually eroded that co-operation. The number of needed services has risen, the volume of goods consumed has expanded, and what was formerly produced within the family began to be bought on the market place.
> The co-operative movement would therefore extend the co-operative system which formerly characterized the family to a control of the market, through the co-operative grouping of families. Formerly, the needs of the family determined production and kept it in balance. In the same way, the needs of the members of

purchase goods for professional or other use at a cheaper price, and enjoy a fairer share of the national income.

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" modern co-operative societies exercise a control and stabilized production."

With the substitution of a capitalist economy for a domestic type of economy, and with mass industrial production which has fathered the division of labour and which requires the co-operation of labour and capital, the importance of money and credit and the need for a soundly organized credit system have been brought to light. Manufacturers and business men, conscious of the essential need for well organized credit, were quick to set up commercial banks, for the purpose of helping them to meet their credit needs and to develop.

In Germany, the craftsmen, faced with a disastrous competition from the new large-scale industry and with the need for credit with which to pay cash for materials they had to purchase collectively (through their purchasers' co-operative) and bent on reducing costs to face competition, in turn proceeded to organize popular banks under the direction of Herman Schulze Delitzsch, a leading economist and humanist.

Meanwhile, what action were the farmers taking? They too were certainly experiencing increased credit needs due to industrialization and the commercialization of agriculture. They put their savings into banks which poured them into large centres and used them for industrial and commercial purposes. However, such capitalist type financial institutions were not interested in loaning money to

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[illegible]

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agriculture, since the latter was unable, in view of its inadequate income, to pay interest rates comparable to the interest available from industry and business.

This unsatisfied need for agricultural credit gave rise, in the middle of the last century, to the rural co-operative credit organization, with Raiffeisen in Germany. Farmers got together on a community basis to borrow funds and later to loan money to one another. They collectively sought funds from lending institutions by assuming joint responsibility for loans granted on their behalf to the co-operative credit society.

Mr. Alphonse Desjardins who for a number of years had been aware of the damage caused among the people by usury, in view of the lack of organization of savings and credit for the working classes, in 1900 set up his caisse populaire in Levis, his native city.

He established it on a co-operative basis, for the purpose of organizing people's savings in terms of popular credit, and thus satisfying the credit needs of our working classes.

2. THE SCOURGE OF USURY

Mr. Desjardins, in 1892, was appointed official reporter to the House of Commons in Ottawa, and, as such, took down in shorthand the parliamentary debates which took place in those years on the excessive rates of interest imposed on the common people, and on the legislative measures intended to

check usury.

Devoting his spare time to the study of economic and social matters, he made a thorough study of the problem of usury. He realized that the law provided no efficient remedy against usury; members of Parliament periodically raised the question of excessive rates of interest in the House of Commons and deplored the inadequacy of the law to protect the small man from the voracious appetite of money-lenders. The revelation of certain usurious practices in the large cities of eastern Canada, such as Montreal, seemed to indicate, moreover, that the evil was spreading.

Mr. Desjardins made a thorough investigation of the situation and thus discovered the extent of the damage usury was causing in our country. In his pamphlet on the caisses populaires, Mr. Desjardins wrote:

> " Certain sensational lawsuits which have taken place in Montreal have brought to light deplorable cases of hard-pressed borrowers who have had to pay merciless money-lenders several hundred per cent in interest on insignificant loans and that is what led us to study the problem and seek methods to solve it."

In a letter dated June 6, 1898, addressed to Henry Wolff, president of the International Co-operative Alliance, Mr. Desjardins confirmed his investigation of money-lending and his desire to find a remedy:

Devoting his spare time to the study of economic and social matters, he made a thorough study of the problem of usury. He realized that the law provided no efficient remedy against usury; members of Parliament periodically raised the question of excessive rates of interest in the House of Commons and deplored the inadequacy of the law to protect the small man from the voracious appetite of money-lenders. The revelation of certain usurious practices in the large cities of [illegible] moreover, that the evil was spreading.

Mr. Desjardins made a thorough investigation of the situation and thus discovered the extent of the damage usury was causing in our country. In his pamphlet on the caisses populaires, Mr. Desjardins wrote:

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" A case which came before the law courts recently,"he wrote,"revealed the existence of usurious practices. The case in point was that of an individual who had to pay 120 per cent interest on a small loan he had obtained from a money-lender. That case is by no means the only one. Indeed, as I wanted to find a remedy against the evil of usury, I have been collecting facts of this kind for some time past and now have an entire file".

Mr. Desjardins realized that it was the lack of organized credit for the working classes that made usury possible and even facilitated it. Credit was organized for trade and industry, the credit system set up by the capitalist regime being, almost exclusively, the monopoly of industrialists and business people who, indeed, were practically the only ones who could take advantage of it. Credit was not organized to meet the capital requirements of farmers, craftsmen or workmen.

"Up to now," stated Mr. Desjardins in his pamphlet on the caisses populaires, "the worker, to obtain the credit he required, has been forced to turn to the small-loan operators, the pawnbrokers or the clandestine money-lenders who never fail to claim their pound of flesh from the distraught victims who fall into their clutches."

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"Up to now," asked Mr. Desjardins in his pamphlet on the people's banks, "the workman, to obtain the credit he required, has been forced to turn to [illegible] usurers, the pawnbrokers or the [illegible] money-lenders who never fail to [illegible] profit [illegible] from the distress of those who fall into their clutches."

[illegible]

"Neither the banks nor the loan companies," wrote Mr. Desjardins in his brief to the Parliamentary committee studying the bill on co-operative and industrial companies,

"...are prepared to meet the credit requirements of the poor because the latter have nothing to pledge but their honesty and intention to repay a loan. .... This deficiency in our economy has been of considerable advantage to a class of pawnbrokers or small loan operators, known today as usurers, who have speculated on the needs of the common people on the pretext of being of service to them."

At the meeting of the special parliamentary committee studying the bill on industrial and co-operative societies, held on February 22, 1907, Mr. Monk, member of parliament for Jacques-Cartier, (Montreal) made the following statements: "It is true that our larger banks have branch offices in rural areas and in the suburbs of large cities but these offices are established mainly for the purpose of getting deposits. It is impossible for a worker, or any one else in a rural area, to obtain a loan from these banks to buy, for example, the equipment they need for their work".

The normal economic life of our country therefore lacked certain necessary machinery, the small man being the victim of usury because of the absence of a credit system adapted to the needs of our working classes. Mr. Desjardins felt that as

long as this deficiency in economic organization existed, the evil of usury would persist, for no law had thus far been effective in preventing small capitalist lenders from taking advantage of the working classes. Mr. Desjardins realized that it was impossible for the government to control loans between citizens, that the money-lenders could evade the federal Small Loans Act and that the amendments to that act were ineffective.

3. THE NEED TO ORGANIZE CREDIT FOR THE PEOPLE

It appeared to Mr. Desjardins that the truly effective means of controlling usury was to give the common people a sound credit system which would get them out of the clutches of usurers and supply them the capital the needed to promote their small enterprises and to prosper.

He then set out to find whether usury existed or had existed in other countries, particulary in Europe, and what remedies were being or had been used to check it. In the Ottawa Library, Mr. Desjardins found, among other treatises on economic questions, a book by Henry Wolff, the British economist and cooperator, on people's banks and co-operative credit unions, under the title "People's Banks". He thus learned how usury had plagued certain countries in Europe and Asia, and how co-operative credit unions had been organized to deal with the problem. Usury is a sign of serious deficiencies in the economic organization of the working classes; the plague of usury in Canada, as he

long as this deficiency in economic organization endured, the evil of usury would persist, for no law had thus far been effective in preventing small capitalist lenders from taking advantage of [illegible] it was impossible for the government to control loans between citizens, that the money-lenders could evade the federal Small Loans Act and that the amendments to that act were ineffective.

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saw it, resulted from the failure of the existing economic system to help the working classes develop a sound credit system. In fact, far from helping the small people to set up credit institutions, the banks drained their small savings into the large centres and the working classes were deprived of much needed credit. The banks were not interested in granting them credit. The small money-lenders were practically the only source of credit for people of modest means, and they took advantage of the difficult circumstances of the people, charging them exorbitant rates of interest on loans.

(a) How to effectively organize popular credit

Mr. Desjardins thus realized that the true solution to the problem of usury was to help the people organize their own credit needs and thus protect themselves against the greed of the money-lenders; the existing economic system was not interested in organizing a sound and effective credit system for the benefit of the working classes, because its own interests were better served when the small savings were being drained towards the large centres where they helped supply the needs of industrial and commercial credit.

Savings and loan institutions, organized by and for the people, were in fact savings and credit co-operative institutions. Through such institutions, the working classes could solve their own credit problems, and would no longer have to rely on outside help. "The road to follow for people desirous of

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managing their own affairs without the burden of outside interference", Mr. Desjardins wrote in his brochure, "is to unite and accept both the advantages and the responsibilities resulting from full control and full participation in the economic life, an essential corollary to the civil and political freedom which we enjoy".

Mr. Desjardins was drawn to the idea of the caisse populaire by his study of the co-operative movement. "Co-operation can, within reasonable limits", he wrote, "be used for all kinds of activities, and to the greatest advantage. After all -- and that is the very essential point of co-operation -- it is the people who manage their own economic affairs. Rather than being ruled today, as people were two or three centuries ago, by an autocratic king who considered himself commissioned by God, we enjoy self-government and settle all matters political through our freely elected members. Why should we not have an equally free system in the economic field? Our political system is essentially democratic, but when you come to our financial or economic system, you find it is ruled in a purely aristocratic or plutocratic way".

Mr. Desjardins quite rightly believed that the caisses populaires were the first step to economic reform in favour of the working classes. In addition to producing citizens with a deep sense of solidarity and service, the caisses populaires would promote a sense of thrift and economy and would organize

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Mr. Desjardins quite rightly believed that the caisses populaires were the first step to economic reform in favour of the working classes. In addition to providing [illegible]

popular credit on a decentralized basis. Educating citizens with a deep sense of solidarity and service, harvesting savings, assuming control of its own capital, such was the first step towards a sound organization of our people's economy. The caisse populaire would provide the means to carry out this first necessary task. Mr. Desjardins himself, in his brief on the organization of agriculture in the provice of Quebec, expressed his convictions in the following terms:

> "We say without hesitation that we hope to see the caisse populaire, that is to say the pooling of modest local capital, become the focus of activity, the driving force of this movement. It has been stated time and again and confirmed by experience that money is the sinew of war. Without the help of money, how utterly weak is any economic endeavour. Now we are faced with a situation which requires us to wage a war on several fronts. One of the most effective weapons at our disposal is to secure the powerful help of credit through the organization of a caisse populaire, which will act as a reservoir of local savings, from which money will flow in the form of loans or advances to give added strength to individual or group initiatives inspired by this renovating movement."

Placing the savings of the people at the disposal of the people: such was the problem on the mind of Mr. Desjardins. He saw it as the essential means to provide the necessary basis for

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a sound organization of our economy. The effective organization of popular credit (which would automatically solve the problem of usury) would be the driving force of the economic life of the labouring classes.

But how could popular savings be so efficiently organized as to meet the credit needs of the people? How could an effective and essential link be established between popular savings and popular credit? How should we introduce in Canada an institution which, by gaining the confidence of the people, could attract and bring together the savings of the people and distribute them wisely among the working classes to properly meet their credit needs? And how could the working classes be helped to set up an institution capable of meeting their credit needs effectively? Finally, how would such a popular credit institution be constituted, supplied and administered?

In reading the House of Commons debates on usury, Mr. Desjardins had noted that in 188[illegible], a member of the House had suggested the creation of agricultural banks operating under the control of the farmers. His study of credit co-operatives in Europe had convinced him, on the other hand, that a popular credit institution, in order to provide the working classes with low cost credit and enable them to free themselves from the usurers, should be the property of the very people who had credit needs to satisfy and should, therefore, be organized

a sound constitution of our economy. The rightly organization of [illegible] would scientifically solve the problem of usury, which is the driving force of the economic life of the [illegible].

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according to the co-operative formula, where the owners, users and beneficiaries are the same people, with equal rights in matters of administration and policy. This popular credit institution where the owners, users and beneficiaries are the same people is none other than the co-operative credit society.

But how can the co-operative credit society adjust itself to our particular thinking, legal framework and environment? Is it possible to introduce such a co-operative organization in Canada? Can it be operated efficiently? Will it attract enough savings to satisfy the credit needs of the common people? It should be noted that European co-operative credit societies were unlimited as to liability. Peasants in need of credit would set up a local co-operative; and the co-operative would then commit everything they owned to secure loans from banks or capitalists. Using solidarity to meet their credit needs, they would severally and jointly pledge everything they owned to provide the needed security for loans which they were granted collectively through their co-operative credit society: it was only by pooling all their assets to provide security that they were able to obtain capital, which they would then distribute among themselves according to their respective credit needs. European co-operative credit societies were borrowers' co-operative with unlimited liability, and later served as personal credit distribution co-operatives.

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Mr. Desjardins did not believe in the possibility of operating an unlimited liability co-operative credit society in Canada, because he could not see how it could effectively adjust to our economic conditions and legal system, where economic or financial institutions were already taking the modern legal form of limited liability companies; he felt certain, as he himself recognized in a letter dated October 18, 1900 to Charles Rayneri, chairman of the banque populaire de Monton, in France, the director of the Centre federatif du credit populaire de France, to whom he submitted the draft constitution of his caisse populaire, that it would be impossible to get our people to endorse the principle of unlimited liability which was the basis of the European co-operative credit society.

> "My reason for rejecting unlimited liability, he wrote, is that I feel sure it is impossible to have such a principle accepted by our people. I adopt the principle of restricting liability to the investment of shareholders".

(b) The source of popular credit must be popular thrift.

Mr. Desjardins felt strongly that popular credit, to be in line with our trading economy which requires heavy capital investments, and also to be fully effective, should feed on popular savings; it should even promote the practice of popular thrift, as thrifty habits insure proper credit training; he rightly believed that credit, in order to be both

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popular and effective, should first be popular in having its source of supply among the people, then in being controlled by the people concerned, who should assume responsibility for its sound administration and for its judicious and low cost distribution; thus it would be true to its goal, which is to effectively meet the credit needs of the working classes. The experience of mutual credit societies in Europe had persuaded him that co-operation should provide the basis principles of an effective popular credit system, because co-operation, apart from requiring personal effort, individual initiative and foresight on the part of credit users, greatly increases their individual strength by uniting and combining their efforts and enabling them to settle their common problems themselves, in a spirit of pride and solidarity.

It therefore appeared to Mr. Desjardins that a popular credit co-operative should first be a savings institution; that is to say an institution which would teach our people the value of foresight, economy or sound administration, and small savings; thus our working classes, while gaining moral strength by practising the virtues of foresight and mutual help, would eventually supply their own credit institutions from their own savings. Such a popular credit institution would therefore have to be both a savings co-operative and a credit co-operative. Mr. Desjardins did not believe that our people's economy could be organized without first encouraging

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a sense of foresight and sound economy among the working people and without harvesting the small savings that would result if these virtues were practiced by our working classes. In a letter dated October 18, 1900, addressed to Charles Rayneri, director of the Centre Federatif du Credit populaire de France, Mr. Desjardins said:

> "With regard to savings, I want our societies to be genuine educational institutions which will teach our people how to practice this social virtue, and to this end we shall accept even five cent deposits."

Mr. Desjardins established the fact that there was not much money to be found among the people and that they were not in the habit of saving. He stated in his evidence to the special parliamentary committee studying the bill on co-operative and industrial societies that "The man on the street gives no thought to putting money aside because in his opinion it is not worthwhile to do so". In his brief on the organization of agriculture in the province of Quebec Mr. Desjardins spoke of the "_contempt shown for putting money aside_" and the "_disregard for small economics_" which exist in our country as "_national failings_" and cause both individual and collective poverty and suffering; they are an overall source of evil for they hold our population in a deplorable state of economic dependence.

A co-operative credit society must therefore

first be a co-operative savings institution, because it teaches the use of credit while acting as a source of credit. The teaching of thrifty habits is the primary task among the small people. Capital grows like a river. It is a matter of gathering all the savings, channelling them and shaping them into an economic power. The first task of the caisse populaire is to stimulate and collect the savings of the people and train the people in the proper use of credit. Its second function is to harness the savings through productive or profitable loans to those who need credit and are able to make good use of it.

On what basis did Alphonse Desjardins establish this co-operative savings and credit institution? On what standards does it operate in order to be a real good school of foresight, economy, and thrift, and to attract the small savings and distribute credit in a wise, effective and economic way?

Mr. Desjardins first considered the family. He fully realized that the family, being the primary element of society, is the first co-operative. Based on the mutual love of parents and children, the family became, with the advent of Christianity, the greatest of social forces. Its success is due to co-operation fortified by Christian charity.

Mr. Desjardins then noted that the parish was a co-operative association of families. Living on a restricted territory within the same parochial community, its members know and appreciate each other

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Mr. Desjardins then noted that the parish was a co-operative association of families. Living on a restricted territory within the same parochial community, the members know and appreciate each other

They are bound by a community of ideas and goals which breeds mutual respect and confidence. The parish acts as a link, enabling families to co-operate in public institutions such as the fabrique, the municipal council, the school board; it calls for their participation in dealing with common problems. Their many and close contacts, their sharing in the same social activities develop a community of spirit and ideas, as well as conditions that are favorable to the effectiveness of a savings and mutual loan co-operative.

In studying the social environment to which he was seeking to adjust his caisse populaire, Mr. Desjardins saw in the parish, where co-operation is so effectively practised, the perfect framework which could provide the caisse populaire with a simple and inexpensive machinery, while ensuring ease of control and great operational efficiency. In the mutual acquaintance of the members, he saw a basic element, a condition of effectiveness and a guarantee of security. In his view, such a restriction of the operations of his caisse populaire to a small territory should apply not only to active operations, such as loans which would be granted only to the members, all living within the territory, but also to passive operations such as savings deposits, which would be accepted only from the members. That is how Mr. Desjardins thought it should be. As he puts it in his pamphlet on the caisse populaire, "we have decided to limit the social activities and

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membership of a caisse populaire to a single and very small territorial unit". The very small territorial unit referred to is the parish, which he described as "the perfect environment for such an institution". "The caisse populaire," he wrote, "is a parochial organization; it is born, grows, develops and prospers in the midst of the parochial community. The parish is its natural birthplace, its focus of activity and it should not overstep its limits".

The thinking of the founder of the caisses populaires on this matter was no doubt based on the opinion that it was neither wise nor economically sound to attract depositors from all sections of an area by means of high interest rates and active publicity, as this might drain into one area too much capital for its needs, at the expense of another area. Such a policy could easily lead to the temptation, for powerful caisses populaires, to go outside their normal field of activity and invest their surplus savings in loans, thus negating the basic principles which guarantee its security and effectiveness. Experience has, in fact, confirmed the value of limiting the operations of savings and credit co-operatives to a restricted territory, where the members are mutually acquainted and where it is easier to loan money wisely and inexpensively. Twelve hundred and fifty (1250) caisses populaires Desjardins affiliated to the Federation de Quebec des Unions regionales des caisses populaires Desjardins are in

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operation in the province of Quebec. The great majority of the caisses populaires Desjardins are parochial institutions, and share the benefits offered by our parochial community organization.

The citizens of a parish know and trust one another, and will be inclined to help one another through their caisse populaire. The fact that they are not all of the same trade or occupation is a factor of stability for their caisse populaire, and a slowdown in a particular economic field (for example the closing of a local industry) will not jeopardize the caisse populaire. With a membership representing various occupational or trade groups, the caisses populaires Desjardins are in a better position to weather economic recessions or periods of unemployment.

The parish, in turn, benefits from the operations of the caisse populaire. "It cannot be denied", writes Mr. Desjardins in his pamphlet, "that an economic organization based on the parish unit will necessarily strengthen the ties that bind our people to their church, making it dearer to their hearts because it will symbolize not only their most noble aspirations but also their material needs, which after all are not to be forgotten. Making the parish a solidly co-operatized focus of every activity directed towards the physical well-being of the people can do no harm to its supernatural mission. Such a close alliance of all the interests involved can only produce healthy results, as mutual support will only make their efforts more effective".

operation in the province of Quebec. The great majority of the existing Desjardins are essentially institutions and share the benefits offered by our parochial community organization.

The citizens of a parish know and trust one another, and will be inclined to help one another through their caisse populaire. The fact that they are not all of the same trade or occupation is a factor of stability for their caisse populaire, and a slowdown in a particular economic field (for example the closing of a local industry) will not jeopardize the caisse populaire. With a membership representing various occupational or trade groups, the caisses populaires Desjardins are in a better position to weather economic recessions or periods of unemployment.

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The caisse populaire adds a useful element to the parish organization. The municipal council looks after the civic affairs of the parish, whereas the schoolboard is responsible for the education of children. There was a need for a popular savings and credit institution to provide financial help for the organization and development of the community's economic life. With the savings harvested within the parish, the caisse populaire has in hand a source of capital which is placed at the disposal of those who can use it productively or to advantage. It stimulates a healthy circulation of capital lends support to local enterprise and helps the citizens buy their own homes.

On the model of the Schulze 'People's Banks' and of the Raiffeisen rural credit co-operatives, and with elements borrowed from the mutual savings banks existing in the New England States, Mr. Desjardins built a savings and credit co-operative. Under co-operative principles, he was able to co-ordinate savings and credit in a single institution solidly based on the parish, in such a way as to use the people's savings to provide credit for the people in an effective and inexpensive way. In studying the operation of the French 'caisses d'epargne', Mr. Desjardins had noted that attempts to reform those institutions (1885-1895) had led to the adoption of the co-operative system and to the addition of a mutual credit service as a means of using savings deposited by the French

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farmers and craftsmen to provide popular credit. He had also noted, in studying savings institutions in other European countries, that the German savings banks, near the end of the last centruy, provided real credit (secured by real or personal property), and in such states as Bavaria, even provided a small amount of personal credit (secured only by the borrower's moral character.) The Prussian savings banks used a substantial part of their funds deposited in savings accounts to provide mortgage loans; by granting credit on real property, they helped the farmers improve their land. The reform movement in the French 'caisses d'epargne' for the co-operative use of their considerable capital by the working classes, and the policy of the German savings banks to provide agricultural credit on the security of real property, and also a certain amount of personal credit, confirmed Mr. Desjardins in his plan to organize a savings and loan co-operative society adjusted to Canadian conditions, based on the principles of the Schulze people's banks and of the Raiffeisen banks, and with elements borrowed from the American mutual savings bank. Recognizing the true value of the traditions of thrift which existed to some extent in certain classes thanks to the banks, the Caisse d'Economie, the Savings Bank of the City and District of Montreal, and considering at the same time the great opportunities offered by our parochial structure in relation to his caisse populaire, Mr. Desjardins thought

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he could use these traditions of thrift and the parish structure as a solid and permanent basis for a savings and credit co-operative institution that would provide machinery to encourage thrift, and redistribute credit to the working classes in a sound, adequate and effective manner. The parish was the link which enabled Mr. Desjardins to successfully combine into a single organization governed by co-operative principles the twin economic functions of providing the machinery to promote popular thrift and of distributing credit to the people.

The subsequent growth and effectiveness of the caisse populaire movement proved that he had been right. "Having carefully studied the mutual savings banks of several American states and looked at their results", he writes in his pamphlet on the caisse populaire, "we came to the conclusion that our own economic units of an exclusively parochial nature should be established on a similar basis". Mr. Desjardins wanted a co-operative credit system. The conclusive experience of the Raiffeisen village banks and of the Schulze people's banks had convinced him that only a co-operative system of credit distributed on a decentralized basis could meet the credit needs of the working classes in a wise, flexible and inexpensive way. Popular credit could be provided effectively and democratically by means of a local co-operative savings and credit association: the Caisse Populaire Desjardins.

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4. PURPOSES OF THE CAISSES POPULAIRES DESJARDINS

The founder has defined the objects of his caisse populaire in the following terms, as found in article 2 of the Constitution of "La Caisse Populaire de Levis", the first such institution, which was founded in 1900.

1. To protect its members against reverses of fortune, the results of enforced idleness, sickness and want, by teaching them the inappreciable benefits of wise providential measures based on mutual assistance and co-operation, and, in particular, by instilling and developing in them the taste for, and the constant and energetic practice of, economy on the most modest scale;
2. To aid them by a wise and prudent system of credit in the form of loans and advances, the proposed employment whereof must be communicated to the association, be approved by it, and be in accordance with the spirit in which it is founded;
3. To enable persons devoid of fortune but who are honest and laborious, to form part of the association by granting them facilities for paying up their shares in the capital stock by means of very small weekly instalments;
4. To secure the practice of the Christian and social virtues that mark the good citizen, the honest, laborious and honourable worker, by exacting above all moral warranties of the

highest order from the shareholders who borrow from the association;

5. To combat usury by means of co-operation, by providing all who are deserving of the same, through their fondness for work, their skill and the integrity of their conduct, with the moneys they require for carrying on their business or occupation, thereby making them independent of lenders who levy exorbitant commission or interest, or of those who impose too onerous conditions in connection with credit;

6. To foster the spirit of enterprise and promote local works, whether of an industrial or agricultural character, by the prudent use of the savings effected within the district covered by the association's operations;

7. To spread amongst its members a practical knowledge of the elementary principles of economic science.

8. To teach them respect for their engagements, and also the advantages inevitably derived by those who faithfully fulfil the obligations they have undertaken;

9. To create and foster mutual confidence between shareholders by means of economic relations based on the security of warranties of a high character, inasmuch as they are founded, in a very great measure, on morality, honesty, order, love of work and prudence;

10. To gradually procure them -- by persevering

efforts towards securing economy and consequently a just measure of credit -- that economic independence which inspires and fosters the feeling of personal dignity and convinces one of the need of relying above all upon oneself to improve one's position and raise oneself in the social scale.

(a) Teaching thrifty habits and the use of credit.

The primary function of a caisse populaire is to stimulate savings, receive, hold and hand them back to its members on demand. **Despite the fact that men have intelligence and foresight,** thrift is not a natural human quality; by nature, man is not inclined to save. Citizens therefore need protection, because at certain times, they are more inclined to spend their money than to save it. The credit union provides this safeguard. It promotes thrift, constantly calling attention to its necessity, facilitates the deposit of savings and is of easy access to all. All small savings must be collected, as otherwise, they run great risks of being squandered. Credit unions try to salvage small savings, which are earned by hard work. Apart from providing facilities for deposits, the Caisses Populaires Desjardins ensure the security and promote the proper use of savings. It is a golden rule which they make it a point to follow in carrying out their primary function as savings co-operatives.

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caisses populaires had to say on the matter.

"Some will object and say: Why have savings co-operatives when we have banks that collect savings everywhere through their branch offices? First of all, banks are not created for the purpose of contributing to the welfare of the people generally or of solving social problems on the economic level. The thought has never occurred to them, and happily so, because they are in no way equipped for such a mission. They would therefore certainly fail in such a task, and would be less successful in making profits for their shareholders, which is their single purpose. Let each institution pursue the particular ends for which it was created, and things will be all to the better.

In the second place, is it true that the banks reach into every community? Apart from the economic danger of such a constant drainage of local savings for the sole benefit of the larger centres, and within those centres, for the sole benefit of a certain number of customers, is it not true, despite the disturbing growth of the branch offices, particularly in the past few years that the vast majority of our parishes are without such storehouses of savings? The explanation is quite simple; it is that the banks is a company created for the sole benefit of its shareholders, and not a social institution primarily designed to serve the people to the

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" limit, without any hope of substantial profit. What the banks is after is profits to fatten the year-end dividends. That is the undisguised truth. Now there are many parishes where the operation of an agency or branch office would be a source of loss rather than gain. The banks therefore stay out. Is this surprising or regrettable? Far from regretting it, we should welcome it if such a default has the effect of stimulating local initiative and causing the people to create a much more beneficial storehouse, one that will be much more appropriate to the needs of our parishes, in the form of a caisse populaire.

Finally, banks do not grant credit to the poor. They lend mainly to people in big industry and business ...... While we are not too concerned with the fate of the banks, knowing full well that they are able and of a mind to look after themselves, we can say that the growth of credit unions would be much to their advantage, as it would increase the flow of savings, and thereby the total wealth of the country, thus increasing economic activity, something which undoubtedly would be beneficial to the banks. Such has been the experience elsewhere, and there is no reason why it would not happen here. Since when have elementary schools been harmful to the university? Must not one learn to read and write before attending an institution of

" higher learning? The credit union is the economic elementary school. No matter what may happen, large banks will never collect penny savings, as this would be too costly in view of their luxurious organization and highly paid staff; a local credit union, however, can easily do this, first through a sense of duty and secondly because of its very method of operation, which is based on social dedication."

The purposes pursued by credit unions through the distribution of credit and the repayment of loans by means of small regular instalments are no different from their goals as savings co-operatives. The credit department of a Caisse Populaire Desjardins is based on the same principles and directed to the same goals as the savings department -- the economic and social improvement of its members -- and the method used in both cases is always the practice of foresight economy and thrift. By having to make small payments on loans, borrowers are encouraged to use foresight and save to repay their loan bit by bit, and to improve their economic and social conditions. This explains why the credit committee must know the purposes of a loan and make sure that it will be truly useful and beneficial to the borrower. It also explains why the credit committee requires borrowers to pledge themselves to small regular payments on their loan, as a means of inciting them to put their financial house in order, use foresight, live moderately and practice, and to make sustained efforts to organize their

business and living habits in such a way as to save money to improve their economic and social conditions. Such is the task of economic and social education performed by the members of a credit committee when they are true to the spirit of the founder, who wanted the caisse populaire to be, in every parish a practical school of economic and social education for the citizens.

(b) Economic education in the homes

The Caisses Populaires Desjardins, as we have pointed out, play an educational role within the parish, teaching foresight, economy, thrift and the use of credit. Their purpose is not only to protect the savings deposited with them and to see that they are properly used, but also to consider effective ways and means of teaching families to manage their affairs properly. When the families in a parish get together to set up a caisse populaire, it is to practice mutual help. Such mutual help is not restricted to the holding and proper use of savings; it must also cover the administrative education of householders. One need only to give some thought to the purposes of a caisse populaire as described in the general statutes of the movement to realize this. The growth of savings has been too slow in Canada to meet the investment needs of an expanding economy. Moreover. either in spite or because of the higher salaries and incomes enjoyed by Canadians, consumer debts have risen considerably since the last war. The standards of living, goals and needs of the family have

undergone great changes as a result of the industrialization and urbanization of our society.

Conscious of their responsibilities to the working classes, and wishing to be adequately informed on present day living conditions and essential needs in our homes, the Federation and the Assurance-Vie Desjardins have asked the committee of economic and social research of the Laval University Faculty of Social Science to undertake a scientific study of living conditions, economic behaviour, aspirations and needs of wage-earning families in Quebec.

This study will reveal the factors affecting the behaviour of families in relation to thrift and the use of credit in relation to their consumer needs. It will define their living conditions, goals, and needs, and will provide scientific data that will enable the Federation des Caisses Populaires Desjardins to design budgets for families of different social environments. The data from such a study will help the leaders of the caisses populaires movement to develop policies concerning savings and credit, and will help them select the most appropriate ways and means of teaching families how to manage a household, make better use of consumer credit and provide for the future.

5. BASIC PRINCIPLES

The Caisses Populaires Desjardins are based on the following co-operative principles:

(a) One member, one vote

A Caisse Populaire Desjardins is a savings

and loan co-operative. The citizens of a parish who freely join together to establish and operate such an institution are the owners of that institution and share equally in its management. Each member has a single vote, no matter how many shares he owns. In his submission to the Special Committee of the House of Commons on the bill respecting industrial and co-operative societies (1907) Alphonse Desjardins wrote:

"What illustrates more than anything else the essential difference existing between a joint stock company and a co-operative association is the principle of 'one shareholder, one vote'. Unlike the society based on capital, whatever may be the number of shares one has, be it large or small, he has only one vote. This system is the direct outcome of the central idea that should always prevail in a co-operative association, that of an aggregation of individuals, not of dollars or capital. One ought to have the privilege of enjoying a large influence because he has put in more money than his neighbour. The voting power being the same for every member, no one can exercise undue pressure on the management of the association, or vote himself into any office where he could control the affairs and manage them according to his own selfish interests. The danger of such societies falling into the hands of shameless speculators, as happens every day

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in joint stock companies, is thereby removed. The basic importance of this principle has been universally recognized. There can be no true co-operative society if this principle is not strictly adhered to."

The parish caisse populaire is a society of people; it is not a society of capital or a joint stock corporation such as a bank or loan company. In a caisse populaire, the vote is attached to the person; in a bank, it is attached to capital stock, i.e. to money. Members take decisions at the annual or special meetings of the caisse populaire according to the principle of one man, one vote, and not according to the rule followed in capitalist enterprise, where each shareholder has one vote for each share he owns. Thus if shareholders of a joint stock bank personally own or are proxies to the owners of fifty per cent of the capital stock (who are absent from the annual meeting) they can control the bank, take administrative decisions and determine the distribution of profits to the shareholders.

The shareholders of a caisse populaire are at the same time its owners, users and beneficiaries. They give it their savings to administer, and borrow from it when they need money. They select from among themselves the members of the three boards or committees responsible for managing the caisse populaire, granting loans and generally supervising the administration. The mutual relationships of the members are therefore on a basis of a social equality

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in accordance with the co-operative principle of one man one vote.

(b) Freedom to join and withdraw

The founding members of a caisse populaire and other citizens in the parish who join in later are freely associated.

The citizens of the parish are therefore free to join the caisse populaire, or to withdraw their membership. A co-operative institution, the caisse populaire is based on persuasion rather than coercion.

(c) Distribution of overpayments or net operational surpluses to members according to their transactions and limitation of interest on capital

The Caisse Populaire Desjardins is a combination of two co-operatives: the savings co-operative and the credit co-operative. It combines two functions previously performed by two separate institutions: the "casse d'epargne" and the credit co-operative. In Europe, credit co-operatives are supplied, at least in part, by means of loans from "caisses d'epargne" commercial banks.

This dual function of the caisse populaire must be born in mind if one is to fully understand how it applies the co-operative principle of distributing the net surplus on operations to members in proportion to their transactions with the caisse populaire.

Any co-operative has two essential elements:

1. It is an association of people;
2. It is an economic venture.

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A co-operative has two essential elements:

1. It is an association of people.
2. It is an economic venture.

This gives rise to two basic rules:

(a) the rule of equality among members in their mutual relations within the co-operative,

(b) the rule of proportionality in the distribution of net operational surpluses to the members.

The rule of equality involves the application of two co-operative principles:

1. One man, one vote, which places all members on an equal footing in the management and control of their caisse populaire;

2. Equal freedom for all to join or not to join the caisse populaire.

The rule of proportionality governing the relations of the credit union with its members in economic matters involves the application of two co-operative principles under which net surpluses on operations or overpayments must be refunded to the members in proportion to their transactions with their credit union. This requires:

1. a limitation of the interest on capital;

2. the distribution of net operational surpluses to the members pro rata to their transactions with the credit union and not in proportion to their capital.

How does a credit union distribute its net operational surpluses? It pays a limited interest rate on capital (membership shares) and on savings. The interest on shares is slightly higher than the interest on savings. The reason for this is that the financial liability of members is legally restricted

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to their shares. The shares (which involve co-ownership) are therefore subject to a certain amount of risk that does not affect savings. It should also be noted that the member pays an entrance fee of every share that he buys. In addition to being a direct contribution to the reserve fund of the caisse populaire, the entrance fee serves to stabilize the share capital; as it is not refundable, the member is likely, once he has paid it, not to withdraw his shares without serious reasons. This explains why the caisse populaire pays its members a higher interest rate on share capital. This interest on shares is called a bonus to differentiate it from interest on savings. It is obviously different from a dividend, which in a bank, represents a distribution of profits on the shares. If the bonus were a dividend, it would follow the profit curve in the same way as a dividend, and the higher the profit or net surplus, the higher the bonus. But such is not the case: the Caisses Populaires Desjardins limit interest on share capital and savings. They treat capital as a good servant, to whom they pay a reasonable wage.

Members deposit their available savings with their caisse populaire in order that the money may be loaned to other members who need money. The caisse populaire pays its depositor members a limited interest, and charges its borrower members a slightly higher rate. The excess of interest received on loans and investments over interest paid on savings should pro-

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vide a net surplus adequate to cover administration costs, to build up the reserves deemed necessary to consolidate the financial position and offset possible losses, and to pay a reasonable interest or bonus on membership shares which determine the co-ownership of the members.

A caisse populaire is not in the money market. It does not allow a small number of shareholders to make handsome profits on the savings of the membership as a whole. Only its members can deposit their savings with the caisse populaire, and only its members may take out a loan. They pool their savings for their own use, and not so that a small group within their ranks will make profits on the other members' money. It neither borrows money nor accepts deposits from other than its members to loan the money for a profit.

Banks, on the contrary, accept deposits of money from anyone and loan to anyone if they think it is good business; they are in the money market, accepting deposits from the public and loaning the money at a higher interest rate for profit. Such profits are divided among their shareholders on the basis of the number of shares they individually own in the bank; as the term dividend clearly implies, profits are divided among the shareholders according to the size of their holdings.

Of course, a caisse populaire cannot exactly foresee the total amount of administration costs or the amount of interest to be paid on shares and savings, as these necessarily vary. If therefore

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charges and interest rates which, in all probability, will more than cover total expenditures and payable interests, plus a contribution to the reserves. If at the end of a financial year there is a net surplus after payment of a reasonable bonus on membership shares, the caisse populaire repay to its borrowers the excess interest charged on loans. By means of this refund or return of net surpluses, operations are brought back to cost.

The amount of this return necessarily varies according to the amount of surplus interest charged on loans. The higher the loan, the higher the interest paid, and therefore the higher the amount returned to the borrower. Thus the rule of proportionality is applied to the return of overpayments, net surpluses being distributed in proportion to the transactions between the borrowers and their caisse populair

In dealing with the distribution of net surpluses, Mr. Desjardins writes in his pamphlet on the caisses populaires:

> "Now credit unions have made it an iron-clad rule to treat them (depositors and borrowers) both with equal justice".

Whenever the bonus is raised, loans terms are improved. This is an application of the co-operative system on which savings and credit societies are based. Though it is a new principle in this field, it is a commendable one, based on true equity and solidarity. Moreover, it must not be forgotten that borrowers also benefit from increased bonuses, because they

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also own shares on which the bonus is paid. It therefore follows that all members have a double interest in the successful operation of the caisse populaire, both as depositors and as possible borrowers.

It was Mr. Desjardins' intention that his caisse populaire should treat depositors and borrowers with equal fairness, by paying to the former a higher interest rate on their shares, and in respect of the latter by reducing the interest on loans by means of returns whenever there is a net surplus on operations.

The caisses populaires apply this principle of fairness to all their members. This rule of treating depositor members and borrower members with "equal fairness" in the distribution of surplus profits is set out in the following terms in article 46 of the general statutes of the Caisses Populaires Desjardins:

> "For any increase in the annual bonus there shall be a corresponding improvement in the terms of loans to members, either in the form of a reduction in the interest rate or otherwise."

It may also happen that at the end of a year, there are no net surpluses to be distributed, after deductions are made for interest on savings, a contribution to the reserve fund in accordance with the by-laws, and payment of a reasonable interest on shares. In such a case, the caisse would not issue returns to the borrowers, but would still remain

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a true co-operative. It is a non-profit organization, and has already provided its services at cost.

6. RULES AND METHODS OF OPERATION

(a) Limitation of the territory of operations

The first rule governing the organization of a Caisse Populaire Desjardins is the limitation of its territory of operations, or in other words the limitation of its activities to a restricted group (the parish) where the members know and have confidence in each other.

The members of a caisse populaire must be honest people and must be mutually acquainted. The mutual acquaintance of members is a requisite for the successful operation and effectiveness of a caisse populaire, which could not be organized or function if its members lacked confidence in one another. It is therefore important that the members be mutually acquainted and be honest citizens willing to help one another.

The board of management of a caisse populaire exercises close control over the acceptance of new members, to ensure that applicants without the required qualifications be kept out. Those qualifications are set forth in the following terms in Article 7 of the Statutes:

> "Must be honest, punctual in his payments, of sober habits and industrious".

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charity. This is possible inasmuch as the members are honest and willing to practice mutual help. After emphasizing the qualifications for membership, Mr. Desjardins (in his pamphlet on the caisse populaire) concludes:

"Therefore a caisse populaire is primarily a society of honest people, and in order to leave no room for doubt on this score, activities are restricted to the limits of the parish where the people are mutually acquainted."

(b) Limited liability of shareholders

The financial liability of the shareholders is limited to their shares in the caisse populaire. Section 3 of the Quebec Co-operative Syndicates Act governing the caisses populaires confirms the fact that the financial responsibility of members is limited to the amount of their respective shares. This section reads as follows:

"A shareholder is liable only for the unpaid portion of his subscribed shares".

This means that the members of a caisse populaire could, under this section of the act, be called upon to complete payment of the unpaid portion of their subscribed shares if the caisse populaire needed the money to honour its obligations; as the paid up share capital is already invested in the caisse populaire, it goes without saying that the members could not in such a case withdraw it. An example should help clarify the point: assuming that

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a caisse populaire, having sustained heavy losses on its loans, is no longer able to operate and is forced to wind up, and assuming that at some point, it is found that the proceeds of loans and investments will not yield enough money to repay to the depositor members their full savings including share capital, then priority will be given to the repayment of loans if any; deposits will rank second. The balance of the assets realized will be used to repay share capital; if this balance is found inadequate to fully cover the deposits, the members will be asked to complete the payment of their shares in the caisse populaire which are not completely paid up. In other words, the liability of members does not go beyond the amount of their share holdings.

(c) Low cost membership share

As indicated previously, one of the purposes Mr. Desjardins had in mind in establishing his caisse populaire was to teach and promote the practice of penny savings, to use his own phrase. He wanted the caisse populaire to be a parish school where everyone could learn the value of pennies and acquire a sense of economy and the habit of thrift. So that no one, even the poorest, would be deprived of the benefits to be derived from membership in the caisse populaire, and to make it quite clear that the primary function of the caisse populaire was to promote small savings, he set the cost of shares at a small amount.

Article 19 of the Statutes of the caisse populaire sets the value of a membership share at

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Article 13 of the Statutes of the caisse

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$5.00, although the Quebec Co-operative Syndicates Act authorizes shares as low as $1.00. However, to make it even easier for the poorest to join a caisse populaire, the General Statutes (Article 20) of the caisse populaire provide that shares shall be payable at a minimum rate of 10 cents a week per share.

Thus, anyone may, if he so desires, joint a caisse populaire, agree to obey its rules, acquire a share and, by attending this parish school of economy, learn the practice of thrift.

Shares always remain at the original value; they are not shares that vary with the market. Shares in a caisse populaire are the property of the members who may withdraw them.

Endorsing the view of Mr. F. A. Nicholson who directed the study on credit in India at the close of the last century, Mr. Desjardins quoted Mr. Nicholson's statement (see the Appendix to the general statement before the House of Commons Committee (in Ottawa) on the bill respecting co-operative and Industrial Societies Act (1907):

> "The society does not consist of a fixed number of transferable shares which may be transferred to and held by any one, but of a congeries of men all personally selected for admission to membership; the holding of a share does not make a man a member as in a joint stock society, but membership gives a right to and requires the holding of a share; the society is an aggregation of members not of shares."

(d) Free administration

The caisse populaire is an institution for moderate income people. Its operation costs are kept to a strict minimum in order to reduce the cost to its members which it is intended to help. For that reason, the founder of the movement wanted its administration to be provided free of charge. Only the manager (and staff) may receive a remuneration. This excludes the payment of fees for attendance at meetings, as well as commissions to officers; their services must be completly gratuitous. The Quebec Co-operative Syndicates Act governing the caisses populaires provides (Section 23): The services of the members of the boards of management, of the board of supervision and of the committee of credit shall be gratuitous. The manager may be paid for his services.

The economic administration of the caisse populaire is made easier by the fact that its activities are restricted to the parish where people are mutually acquainted. "All transactions of the association which yield profits or benefits shall, being essentially co-operative, be confined to the members. Such transactions according to Section 6 of the Act, shall not be deemed to be the operation of a business, financial establishment, or means of profit."

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yield profits or benefits, being essentially co-operative, are confined to its members. Only the members may share in the operations of their caisse populaire. Only the members may deposit their savings or take out a loan. The co-operative nature of the operations of the Caisses Populaires Desjardins, which is recognized by legislation, has also been given recognition by the Federal taxation authorities. In 1930, when an amendment to the Income Tax Act was introduced to exempt credit unions from income tax, the Hon. Euler, then Minister of National Revenue declared:

> "The members of those organizations (the Caisses Populaires Desjardins or credit unions) contribute their money for one purpose only, that those moneys shall again be loaned to the members themselves.
> It is entirely a co-operative institution."

The result is that operation costs are reduced to the very minimum. This is to the benefit of both depositors and borrowers; thanks to this administrative economy, they enjoy more favourable interest conditions.

The caisse populaire benefits in another way from the gratuitousness of adminstrative services. Those who are elected to office in a caisse populaire are not driven by considerations of profit or financial reward. Their willingness to hold office stems from a sense of dedication and social mindedness; the principle of the gratuitousness of services tends

to favour the election at the head of a caisse populaire of dedicated and unselfish persons. Being unpaid, whether in the form of attendance fees or otherwise, the directors and credit committee members have no interest in involving the caisse populaire in risky loans or deals; they do not see in their caisse populaire personal financial interests to be protected at all costs.

The gratuitousness of services, which calls for unselfishness and social mindedness, is a guarantee of sound administration and security for the caisse populaire.

(e) Setting up of an indivisible financial reserve

From a portion of its annual net surpluses, the caisse populaire accumulates a financial reserve to protect itself against possible losses and to gain strength so as to render greater services to its members.

Such reserves belong to the caisse populaire in its own right and can never be distributed to the members. Should the caisse populaire be wound up, the balance of its realized assets, including of course the reserves which belong to it in its own right, is distributed or applied, within the territory of the caisse populaire, to one or more works of general public utility designated by the Lieutenant-Governor in Council. Such a provision precludes any temptation, on the part of the shareholders, to distribute to themselves the reserves of their caisse populaire. Such reserves contribute to the depositor members'

confidence in their caisse populaire, by protecting their savings against possible losses.

The members thus benefit from the payment of part of the net operational surpluses of their caisse populaire into an indivisible financial reserve, while the reserve fund is the property of the caisse populaire and may not be divided, this does not make it unproductive. It yields interest which enable the caisse populaire to improve interest rates on savings and to reduce the rates on loans. Such a common fund (which is gradually built up through administrative economies resulting from the use of unpaid officers and from the simple and economical system of restricting operations to members living within the parish) works to the benefit of all members, both depositors and borrowers alike.

Section 39 of the Quebec Co-operative Syndicates Act requires the caisse populaire to apply to reserves at least 10 per cent of their annual net surpluses. The General Statutes of the Caisses Populaires Desjardins are more demanding. They provide for the payment of 20 per cent of annual net surpluses into the reserve fund, and of 10 per cent into the contingency fund. The various affiliated Caisses Populaires Desjardins annually apply at least 30 per cent of net surpluses to reserves.

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the caisses populaires to be of greater service to their members by granting them loans more in keeping with their needs at more favourable terms.

(f) Loans granted to members only

The Quebec Co-operative Syndicates Act governing the caisses populaires requires the latter to grant loans only to their own members. Section, paragraph 2, provides as follows: Transactions of the association which yield profits or benefits, shall, being essentially co-operative, be confined to the members. Confining loans to the members contribute to the security and efficiency of the caisses populaires. To maintain a balance between its two services, savings and loans, and to enable the caisse populaire to fulfil its true function, it is important that both borrowers and depositors be members, that is to say, that the caisse populaire grant loans only to is members. Otherwise, the depositor members might eventually influence the policies of the caisse populaire to the disadvantage of the borrowers, who might have to pay somewhat excessive credit terms; not being members, they could not, through their vote, call for remedial action or for a more favourable treatment.

Here is a statement on the subject by Mr. Alphonse Desjardins before the special committee of the House of Commons on the bill concerning co-operative and industrial societies (1907):

"In the first place, only the shareholders will have a right to borrow from the association,

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"and it must not be forgotten that the members are selected and accepted after an investigation conducted by a control board representing the association, something which provides an additional safeguard."

In his book on "Co-operative Credit Banks", Mr. Wolff right emphasizes this point:

"The first safeguard relied upon is the election of the person to whom the loan is made, as a trustworthy, respectable, presumable honest and honourable person. Lending to non-members would be altogether contrary to the principle of the bank." (Co-operative Credit Banks, p. 28)

(g) The Loan Policy

In view of the founder of the caisses populaires, savings should precede and in a sense justify credit. Any co-operative is based on the personal efforts of its members and on their mutual help. In the caisses populaires, savings reflect the personal efforts of the co-operators while the money they loan from their collective savings reflect their mutual help. Members make an effort to save in order to deserve credit. It is in that sense that in a caisse populaire, saving precede credit and at the same time provide it.

Savings justify credit. It is a matter of common experience that the thrifty usually make proper use of credit. Through the systematic practice of thrift, they develop a sense of economy, measure and

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order, qualities which will all help them make use wisely of credit.

The Hon. F.A. Nicholson, who directed a committee appointed by the government of India to investigate rural co-operative banks abroad with a view to their establishment in India, stressed this fact as follows in his report:

> "Credit, to be safe and sanative, must be preceded by thrift; not merely in the sense that the capital to be lent first must be saved, but that it is the man who saves who is the man that ought to get and can use credit."

This explains why only the members are allowed to deposit with or borrow from their caisse populaire. They pool their savings for the purpose of loaning the money to those among them who need it. All may need a loan at some time. They build up their credit on mutualized savings, and help each other by means of loans.

The single principle or golden rule governing the loan policies of a caisse populaire is that of mutual service between the members. The caisses populaires Desjardins must help their members through productive or beneficial loans. The credit committee must satisfy itself that the requested loan would improve the borrower's situation. In his brief to the House of Commons committee on the bill concerning co-operative societies, in 1907, Mr. Desjardins wrote that the caisse populaire must

"..help its members by a wise use of credit for production or obtain a saving on an expense that would be higher if money could not be had at the proper time. It is not mere credit for the sake of the benefit to be derived by the lender that is granted, as banks do, for instance, provided the security is good, but it is one of a particular kind, the really productive credit that is looked for and satisfied."

The statutes of the Caisse Populaire Desjardins place a strict obligation on the credit committee to allow only useful or advantageous loans to the members. According to the chapter dealing with the credit committee, section 66, paragraph 5 of the General Statutes of the Caisses Populaires Desjardins:

"It must know exactly what the borrower intends to do with the money requested, and must refuse any loan that is to be used for a frivolous, extravagant or unproductive purpose, or even for a purpose that is harmful or dangerous to the true interests of the borrower, due to his inexperience or for some other reason."

The caisses populaires, whose sole object is to help their own members cannot and must not grant loans unless they are productive or beneficial to the borrowers; loans which, according to the very phrase of the founder, are intended to "help them, make them more prosperous".

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To make the point clearer, Mr. Desjardins, in his brief to the House of Commons committee in 1907, also quoted a few excerpts from the report of the Hon. F. A. Nicholson, who at the close of the last century investigated credit co-operatives in Europe as a preliminary to introducing co-operative credit in India. On the use of credit, the Hon. Nicholson had this to say:

> " It is not merely cheap and facile credit that is needed; it is not money lent on easy terms without regard to the use made of the money; it is guarded, guided and productive credit that is the necessity of the times; the form which organized credit must take must in itself be a safeguard, a guide and a restraint, so that credit may be used not for mere extravagance or without intelligent foresight, but only in such a manner as will be conducive to prosperity and production."

The value of credit depends not on the goods it provides but rather on the use to be made of the things thus provided. Goods that are consumed on a farm obviously are destroyed; but such consumption is directed to productive or advantageous ends, namely to make the farm more prosperous. Granting loans only for the purpose of improving the situation of their borrower members, a caisse populaire must consider every loan application and satisfy itself that it will be used to advantage.

To make his point clearer, Mr. Desjardins, in his brief to the House of Commons committee in 1907, also quoted a few excerpts from the report of the Hon. F. A. Nicholson who at the close of the last century investigated credit co-operatives in Europe as a preliminary to introducing co-operative credit in India. On the use of credit, the Hon. Nicholson had this to say:

"It is not merely cheap and facile credit that is needed; it is not money lent on easy terms without regard to the use made of the money; it is guarded, guided and productive credit that is the necessity of the times; the form which cooperative credit must take must in itself be a safeguard, a guide and a restraint, so that credit may be used not for mere extravagance or without intelligent foresight, but only in such a manner as will be conducive to prosperity and production."

The value of credit depends not on the goods it provides but rather on the use to be made of the things thus provided. Goods that are consumed on a farm obviously are destroyed; but such consumption is diverted to productive or advantageous ends, namely to make the farm more prosperous. Granting loans only for the purpose of improving the situation of their borrower members, a caisse populaire must consider every loan application and satisfy itself that it will be used to advantage.

The prospective borrower must therefore candidly disclose his purpose in seeking a loan. In his brief to the House of Commons committee on the bill concerning co-operative societies (1907) Mr. Desjardins had this to say on the subject:

> "But what is of paramount importance both tro the borrower and to the society, and is a serious element of surety for the punctual repayment of the loan, as evidenced by an experience extending in Europe over half a century with uniform good results, is the obligation on the part of the borrowing member to state clearly the purpose for which he asks for a loan. The by-law requires that he shall do so, and if he does not comply with this rule the loan is invariably refused, however good may be the surety offered. This is a valuable safeguard for the association."

The members of the credit committee must determine whether the borrower member, if granted a loan, would be likely to make a profit, improve his financial position and repay his loan. In his brief, Mr. Desjardins quotes a most significant excerpt from Henry Wolff's book on co-operative credit banks. It provides such a good account of the benefits derived from the sound use of credit and from its close control by the credit committee that we cannot resist the temptation of quoting it at length:

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"The member is presumably honest. But does his intended outlay promise a return -- will it repay itself? And is it legitimate in his particular case?

These questions are very searchingly considered and according to the judgment passed in committee, under a sense of responsibility kept carefully alive, is the answer given. The committee are in respect of this matter strictly bound, not only by rules, and by their liability engaged, but, in addition to this, by the acknowledgement that all that they do will be from time to time inquired into very carefully by an independent controlling body above them, which, in the interest of the bank, will not allow them to 'stretch a point'. There is no difficulty made, if the case should be thought to warrant it, on the score of amount or of time. A loan, to be a real help, must be adequate to its purpose. And it must also be granted for a sufficient length of time to make it practicable for it to repay itself out of its own production -- or else the borrower will find himself hampered rather than helped, driven to taxing other sources of income in order to repay. But the object must be sound, and it must be legitimate. It may be to enable the borrower to procure for himself materials for his trade. It may be to enable him to tide

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"a slack time or avoid a loss by selling commodities below their proper value. It may be to assist him in doing more ample justice to his opportunities, in trade, on his farm or in his domestic economy. He may want to drain a field, to sink a well, to buy a cow or a pig, to build a shed or a house, or to make a road. It may be to enable him to purchase for cash at a considerable economy goods which he wants and for which otherwise he would be made to pay 'though the nose'. It may be to get him out of a usurer's clutches. Many and many a loan has been granted for this purpose, with the very happiest results, to poor wretches who, almost ruined by usury, had scarcely a shred of solvency left. But all this has to be inquired into carefully by men who know the applicant, know his circumstances who can watch him, verify facts, and who have a strong personal interest in not exposing themselves to loss."

The proper use of credit calls for moral and professional qualifications on the part of the borrower, To get a loan from his caisse populaire, a member must satisfy certain requirements which obviously will commend themselves to the credit committee. He must be a good member, that is to say "honest, punctual in his payments, sober and industrious" (Article 7 of the statutes).

[illegible]

[illegible]

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In considering a loan application, the credit committee first considers the moral sureties of the borrower, then his financial standing. Honesty is the greatest asset and is given primary consideration. To quote the phrase of Luzzati, the founder of popular banks in Italy, credit co-operatives are "the capitalization of honesty". That is the very basis of their credit policy. The caisse populaire gives primary consideration to moral character and to the professional qualifications of the borrower, then it looks at the borrower's financial position. It assures itself that the loan would be used for a productive purpose and will be repaid on the terms suggested by the borrower and found acceptable by the credit committee.

Article 66 of the statutes of the caisse populaire provides that "the committee on credit shall examine all applications for credit, ascertain the solvency of the applicant as well as the moral and material guarantees offered." This article of the constitution of our credit unions clearly repudiates any list setting out in advance what the caisse populaire may loan to each of its members. The credit committee adjudicates every loan after considering the moral and physical securities offered by the borrower and approves the loan only when it is morally satisfied that the borrower will use it to advantage and will repay it.

7. <u>ADMINISTRATIVE BODIES</u>

(a) <u>The general meeting of shareholders</u>

The caisses populaires are administered,

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managed and controlled by their shareholders, who are at once their owners, users and beneficiaries. Being co-operative in form, they are democratic both in their organization and in their operations. The shareholders, who are the joint owners, have the rights and duties inherent in ownership. The greatest responsibility of the caisse populaire rests with the general meeting of shareholders. It follows that the first and foremost administrative body is the general meeting of shareholders.

The rights and duties vested in the other administrative bodies of the caisse populaire, namely the board of management, credit committee and board of supervision, are rights and duties resting primarily with the general meeting of shareholders. As it is impossible for the general meeting of shareholders to directly assume the management of the caisse populaire, and as the same persons could not discharge all the administrative, managerial and supervisory duties, the general meeting of shareholders delegates some of its powers to various administrative bodies.

The Quebec Co-operative Syndicates Act provides for the appointment by the general meeting of shareholders, of three administrative bodies:

(1) The board of management, which is reponsible for general administrative matters;

(2) The credit committee, which has the very special administrative responsibility of studying the loan applications filed by members, allowing

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(1) The board of management, which is responsible [illegible]

(2) The credit committee, which has the very special administrative responsibility of studying the loan applications filed by members, allowing

or rejecting them and seeing that the loans are regularly reimbursed;

(3) The board of supervision, which sees that the board of directors and credit commission faithfully discharge their duties.

The legal organization of the Caisse Populaire Desjardins is in line with its governing principles and goals. It is simple but adequate to ensure full operational efficiency and sound administration.

The general meeting is opened to every shareholder, but under the Act, no particular number of members is required to form a quorum. This is provided in the following terms in Section 25 of the Quebec Co-operative Syndicates Act which governs the caisses populaires:

"No particular number of associates shall be required to form a quorum at a general meeting. No shareholder may vote by proxy except the societies or public bodies that hold shares, each of which shall have one vote only. Each shareholder shall have one vote only, whatever may be the number of his shares."

The Act strictly forbids individual shareholders to vote by proxy. Only societies or corporations holding shares "may be represented and vote through a delegate". (Section 25 of the Act).

(b) <u>The board of management</u>

The general meeting of shareholders elects the members of the board of management (directors)

[illegible]

[illegible]

(4) [illegible]

the board of directors and credit commission [illegible]

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(b) The board of management

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[illegible]

from among the membership (Section 17 of the Act) for a three-year term. One-third of them are replaced every year. Directors whose terms have expired may be re-elected. At the first meeting following the general meeting of shareholders, the directors appoint from their own membership, a president, a vice-president, a secretary and a manager. However, the office of manager may be held by the president, vice-president, or secretary. The president, vice-president, and secretary of the board of management are at the same time president, vice-president and secretary of the caisse populaire. The mode of election and duties of officers are governed by the Act.

The board of management administers the caisse populaire and is responsible for its proper management. It generally directs the operations, sees that the decisions of the general meeting of shareholders are carried out; that the statutes and by-laws of the Caisse Populaire are faithfully applied; and invests in sound bond issue to ensure the best possible use of that portion of savings, which, for reasons of administrative security, cannot be tied up for any great length of time in loans, in view of the possibility of withdrawals. It is also responsible for preparing the annual report on the operations of the caisse populaire, to be submitted to the general meeting of shareholders; for calling the general meeting of shareholders; for

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filling such vacancies as may from time to time arise within either of the three governing bodies of the caisse populaire; for ensuring that the caisse populaire will do the utmost to discharge its duties within the parish and pursue the economic, social and moral goals for which it was founded.

(c) The Credit Committee

Section 22 of the Quebec Co-operative Syndicates Act provides for the appoontment by the general meeting of shareholders of a credit committee of at least three members. With the exception of the president of the caisse populaire, if the by-laws permit, no member of the credit committee may be a member of the board of management or board of supervision. The annual general meeting of shareholders therefore elects the members of the credit committee from among the shareholders by a simple majority vote. Under the statutes of the caisse populaire, they are appointed for a three-year term and one-third of them are replaced each year. They may be re-elected at the expiry of their term of office.

Members of the credit committee may neither directly nor indirectly borrow from the caisse populaire, nor become security for another borrower, under the very terms of Section 22 of the Quebec Co-operative Syndicates Act.

The manager of the caisse populaire is ex officio secretary of the credit committee. He must keep a register in which the decisions of the credit

committee are recorded. The minutes of all meetings of the credit committee must be signed by the members of the committee in attendance and by the manager who acts as secretary.

At least two members of the credit committee (one-half plus one) must be present at a meeting for its decisions to be valid. No decision on an application for a loan is valid unless it receives the unanimous support of the members present.

The credit committee has a very special task. It studies loan applications from the members, accepting or rejecting them, and sees that loans are repaid. It should be noted that in this matter, the credit committee performs an administrative function. It may not override the decisions of the board of management, which is responsible for ensuring the financial security of the caisse populaire. Thus the board of management may from time to time determine by way of a resolution the amount which the credit committee shall be authorized to loan to the shareholders within a given period of time from accumulated savings; the credit committee must remain within the limit established by the board of management and co-operate with the board, which is responsible for the proper management of the caisse populaire and for the financial security of the savings in its custody. The credit committee examines every application for a loan, verifies the financial position of the applicant, assesses his moral worth, satisfies itself

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[illegible]

that the loan is to be used for a proper purpose and decides to the best of its ability whether the loan shall be granted or denied and in the former case, on what terms.

(d) The board of supervision

To ensure that the board of management and the credit committee will properly discharge their responsibilities at all times and that the caisse populaire will thus be faithful to its goals, the general meeting of shareholders also elects a board of supervision whose purpose is to represent the general meeting alongside theboard of management and credit committee in the course of the operations of the caisse populaire. The board of supervision is, in a sense, a permanent general meeting of shareholders. The general meeting of shareholders cannot be sitting constantly, or meeting from time to itme in the premises of the caisse populaire to supervise its operations and see how the members of the board and members of the credit committee are discharging their duties. It therefore delegates this necessary task of supervision and control to a few persons qualified to act in its name and appointed from amongst the membership. The rights and powers of such a supervisory board are therefore primarily vested in the general meeting shareholders, and are exercised for and on behalf of the shareholders. It is a right and duty for co-operators to know what their caisse populaire is and does; being its founders, promoters and masters, they must maintain it so that

it will work in their general interest. This principle of democratic control by the shareholders is applied in several ways in the Quebec Co-operative Syndicates Act, which provides:

(1) (Section 25) that "each shareholder shall have one vote only, whatever may be the number of his shares";

(2) (Section 20) that "the general meeting of shareholders shall appoint from among its members a board of supervision of three members";

(3) finally, (Section 27) that "the general meeting (of shareholders) shall be held each year, within the sixty days following the close of the fiscal term, to take cognizance of the annual report for the previous term and to consider generally the business of the association".

Section 21 of the Quebec Co-operative Syndicates Act defines the functions of the board of supervision as follows:

"The Board of supervision shall exercise supervision over the board of management and the committee of credit as to all the details of their management. It may, at any time, inspect all documents and the keeping of the books, and require the production of the cash on hand. The board of supervision of every co-operative syndicate for credit, provident or other economical purposes shall, at least once a year, cause all the

"operations of the association to be audited by an inspector of a federation organized under Section 49".

The Quebec Federation des Unions regionales des Caisses populaires Desjardins sees that every caisse populaire has the benefit of at least one complete annual inspection carried out by one of its official inspectors. It also sees that the inspection report is studied by the officers of the caisse populaire and that its recommendations are acted upon.

Section 71 of the statutes of the caisse populaire goes into greater detail as to the duties of the board of supervision:

" The members of this council shall watch over all the operation of the association; frequently check the cash, the investments and securities; see to the carrying out of the by-laws, regulations and decisions of the general meeting. They shall check every decision of the committee of credit especially as regards loans and renewals. They shall ascertain the true value of the securities in hand and, in a word, take cognizance of all the documents they deem useful for the performance of their duties. The board of supervision is bound to call an emergency general meeting of the shareholders if they find anything serious in connection with the management of the association's affairs or any

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by an inspector of a Federation registered
under Section 45".

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"violation of the statutory provisions relating to the administration of the moneys paid into the caisse or of the securities exacted for the repayment of loans. They may, in the event of emergency or of extraordinary cases, suspend employee and members of the committee of credit, but shall at once report their reasons to a general meeting of the shareholders who shall decide on the same.

They shall, when the case is not of sufficient importance to necessitate the calling of a general meeting of the shareholders, report their observations in writing to the board of management. The latter shall be bound to act accordingly and, if necessary, to remedy the state of affairs pointed out so as to remove all subjects of complaint. Should the council of administration not act, refuse to take up the matter, or neglect to take the proper steps to remedy the state of affairs pointed out whereof the committee of supervision are constituted judges, they may bring the matter before the next ordinary or special general meeting that may be held."

8. ORGANIZATIONAL STRUCTURE OF THE CAISSES POPULAIRES DESJARDINS MOVEMENT

The Caisses Populaires Desjardins movement in Quebec is organized on three different levels:

(1) the caisses populaires;

(2) the regional unions;

[illegible] relating

to the administration of the [illegible]

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Should the council of administration not act,

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general meeting that may be held. "

3. ORGANIZATIONAL STRUCTURE OF THE CAISSES POPULAIRES [illegible]ING MOVEMENT

[illegible]

in Quebec is organized on three different levels:

(1) the caisses populaires;

(2) the [illegible] unions;

(3) the provincial federation of the Unions regionales des Caisses Populaires de Quebec.

(A) The regional unions

1. Definition

The Caisses Populaires Desjardins are associated on a regional basis to promote and protect their common interests. This association on a regional level is the regional union. It is the second floor of the co-operative savings and credit building. The caisses populaires of the province of Quebec have set up ten regional unions.

1237 Caisses Populaires Desjardins are affiliated to the ten regional unions.

The regional unions are at the service of the affiliated caisses populaires. They are responsible for promoting and protecting the savings of the caisses populaires while at the same time consolidating the savings of the caisses populaires while at the same time consolidating the savings of the caisses populaires while at the same time consolidating the movement and making it more effective.

2. Territory of jurisdiction

As a general rule, the regional unions have adopted the same territorial limits as the diocese. Exceptions are made for the regional unions of Trois-Rivieres, Quebec and Montreal, as described elsewhere.

3. Annual contribution

All of these professional and technical services are financed exclusively from the annual

(2) the [illegible]
[illegible]

(A) [illegible]

1. [illegible]

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3. [illegible]

All of these professional and technical services are [illegible]

contributions of the caisses populaires and from a very small subsidy paid by the provincial government.

The annual contribution of each caisse populaire affiliated to a regional union is a double one:

1 - A charge of 1/10 of 1% on the assets as at December 31;

2 - A further charge of 2% of gross profits for every financial year.

Example:

	1/10 of 1%	2% of profits	Total
Caisse populaire with assets of $10,000.	$ 10.00	$ 6.50 (approx.)	$ 16.50
Caisse populaire with assets of $10,000,000.	$10,000.00	$6,500.00	$16,500.00

The regional union divides this contribution as follows:

1. The first 10 per cent goes into the Security Fund administered by the Federation.
2. The remainder, namely 90 per cent, is divided on the basis of 60 per cent to the Federation des Caisses populaires and 40 per cent retained by the regional union.

In short, on every contribution dollar paid by a caisse populaire, $0.10 goes into the Security Fund, $0.36 to the regional union and $0.54 to the Federation des Caisses populaires.

Only the Montreal regional union has a different contribution basis. It charges its caisses populaires 1/6 of one per cent of assets

as at December 31, without any other charge on gross profits. Five per cent of contributions is paid into the Security Fund, and 55 per cent of the balance is paid to the Federation, a ratio approximately equal to that of other regional unions. The Montreal regional union administers its own security fund for the benefit of its affiliated caisses populaires.

CONTRIBUTIONS DES CAISSES PAR UNION REGIONALE

du 1er avril 1961 au 31 mars 1962

UNION REGIONALE		CUMULATIF 1er avril 1961 - 31 mars 1962	COMPARATIF au 31 mars 19
Trois-Rivières			
1/10 de 1%		$ 55,530.05	$ 50,155.42
2%		49,461.57	45,339.98
	TOTAL:	$ 104,991.62	$ 95,495.40
Québec			
1/10 de 1%		$ 117,471.22	$ 105,523.74
2%		101,364.28	91,353.28
	TOTAL:	$ 218,835.50	$ 196,877.02
Montréal			
1/6 de 1%		$ 251,351.73	$ 219,021.24
Gaspé			
1/10 de 1%		$ 4,079.51	$ 3,720.48
2%		3,437.88	2,977.10
	TOTAL:	$ 7,517.39	$ 6,697.58
Sherbrooke			
1/10 de 1%		$ 18,455.01	$ 16,184.34
2%		15,699.26	13,890.62
	TOTAL:	$ 34,154.27	$ 30,074.96
Rimouski			
1/10 de 1%		$ 12,847.51	$ 11,491.25
2%		10,331.96	9,540.92
	TOTAL:	$ 23,179.47	$ 21,032.17
Chicoutimi			
1/10 de 1%		$ 14,190.49	$ 11,227.69
2%		12,346.62	12,540.53
	TOTAL:	$ 26,537.11	$ 23,768.22
Ouest-Québécois			
1/10 de 1%		$ 1,960.48	$ 1,705.75
2%		1,795.41	1,511.12
	TOTAL:	$ 3,755.89	$ 3,216.87
St-Hyacinthe			
1/10 de 1%		$ 23,198.51	$ 19,237.22
2%		19,482.81	16,162.79
	TOTAL:	$ 42,681.32	$ 35,400.01
Joliette			
1/10 de 1%		$ 14,293.91	$ 12,348.26
2%		11,827.39	10,254.99
	TOTAL:	$ 26,121.30	$ 22,603.25
TOTAL:			
1/10 de 1%		$ 513,378.42	$ 450,615.39
2%		225,747.18	203,571.33
GRAND TOTAL:		$ 739,125.60	$ 654,186.72

4. Internal Management

(a) General meeting

The general meeting of the regional union includes a delegate from each affiliated caisse populaire. The rules of procedure are the same as in a local caisse populaire.

(b) Board of management

The board of management is usually appointed from among the delegates of affiliated caisses populaires. In most unions, any member of a caisse populaire is eligible.

(c) Credit committee

The same rules apply.

(d) Board of supervision

The same rules apply.

5. Services

(a) Educational

Regional unions advise their affiliated caisses populaires, stimulate them, supervise them and help them fulfil their goals.

They strive to improve the co-operative and social education and technical training of officers of the caisses populaires. The regional unions have propagandists and instructors who regularly visit the caisses populaires. They provide to the board of management, credit committee and board of supervision of the caisses populaires the assistance they need for th proper discharge of their duties. They supply needed information to managers, helping them where necessary to balance their books and prepare

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financial reports, training them in any of their tasks. They attend the general meetings of shareholders of the caisses populaires, and take every opportunity to educate the members in the co-operative movement and to urge upon them the need for thrift, saving and of the proper use of credit.

The regional unions help establish caisses populaires in parishes where none exist and where one is desired.

(b) Financial - The regional or central 'caisses'

The regional unions operate a savings and credit service known as the regional or central caisse, which ensures the financial consolidation of the caisses populaires movement and provides for a more complete use of savings. The regional caisse also acts as a clearing house for payment orders and cheques. Occasionally, they grant loans to their affiliated caisses populaires. They also help the affiliates make better use of their surplus savings by finding them first rate bonds at the lowest possible costs.

It should be noted however that the regional caisses do not loan money to affiliated caisses populaires to enable them to increase their loans to their shareholders.

(B) The Quebec Federation of The Unions regionales des Caisses Populaires Desjardins

1. A few historical notes

In 1932, the regional unions of Trois-Rivieres, Quebec, Gaspe and Montreal (which at the

time were the only ones in existence joined together and set up the Federation provinciale des Unions regionales des Caisses populaires Desjardins to provide greater consolidation and protection for the caisses populaires movement.

The six other regional unions which were subsequently set up joined the Federation provinciale de Quebec des Unions regionales.

2. Role or functions

An agency of unification and direction in doctrinal matters and of co-ordination in practical matters, the Federation des Unions regionales des Caisses populaires completes the structure of the co-operative savings and credit movement in Quebec.

It promotes the interests of the caisses populaires movement and spreads co-operative ideas concerning popular savings and credit. By ensuring co-operation between the regional unions and the regional caisses, it consolidates the savings and credit co-operative movement and enhances its effectiveness.

3. Governing bodies

(a) General meeting

The general meeting is composed of five (5) delegates designated by the board of management of each affiliated regional union.

(b) Board of management

The board of management is composed of two (2) delegates designated by the board of management of each affiliated regional union.

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(b) Board of management

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(c) Executive committee

The executive committee of the Federation includes the officers of the society and at least two persons designated by the board of management from among its members at the first meeting following the annual general meeting.

The executive committee of the Federation carries out the general or specific decisions of the board of management, assists the manager in his tasks and takes all decisions required for the management of the Federation's day to day business.

4. Services

(a) The Secretariat

1. Documentation and information centre

2. Records

(b) Education and propaganda

1. Revue Desjardins

2. The newspaper "Ma Caisse"

3. Publications or pamphlets

(c) Stationery

The other services (inspection, legal advice, office machines and statistics) are described in part II of this brief.

9. THE 'SOCIETE D'ASSURANCE DES CAISSES POPULAIRES'

To protect the interests of their members, the Caisses Populaires Desjardins in 1944 founded the Societe d'assurance des Caisses populaires and subscribed the necessary capital for its operation.

Incorporated in March 1944 under VIII, George VI, Chapter 80, which was later amended in

February 1961, the Societe d'Assurance des Caisses Populaires issues, through its represenatives, insurance policies covering fire, civil responsibility, registered mail, theft, bonding, combined protection for home, personal responsibility, employer responsibility, fidelity guarantee and automobile. In addition, under its all-inclusive protection policies issued to all caisses populaires, the latter are compensated for any loss of money or valuables resulting from dishonest actions on the part of officers and employees, theft, armed robbery, break-ins and damages therefrom, falsification or alteration of or on any trade bill or document, including the loss of money and valuables sent by registered mail. Such a contract is usually difficult to purchase from insurance firms and is often very costly in view of the ever-increasing number of thefts.

Caisses populaires operate in most cities and towns of the province, and some are located in remote territories where there is no fire protection, thus making it difficult to obtain fire insurance overage on buildings used as security for loans. The Societe d'Assurance des Caisses populaires provides them the needed protection.

The board of management of the Societe d'Assurance des Caisses Populaires is composed of fifteen members. Without regard to the capital subscribed by the caisses populaires, ten members represent and are elected by the insurance policy

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holders; the five others represent the caisses populaires.

The Societe d'Assurance des Caisses Populaires was therefore set up for the purpose of compensating its members for the loss of physical assets due to fire, theft, bodily injuries or death resulting therefrom, accidents, while contributing to the national economy.

10. THE 'ASSURANCE-VIE DESJARDINS'

The Assurance-Vie Desjardins was incorporated in 1948 "for the purpose of promoting and safeguarding the general interests of co-operators and members of caisses populaires". It is a mutual company whose share capital was subscribed by the caisses populaires and which is the property of the latter and of all its policy holders. Three of its directors are elected by the caisses populaires and the others are jointly elected by the caisses populaires and the policy holders. In 1959, the provincial charter of the Assurance-Vie Desjardins was replaced by a federal charter which now enables it to offer its services across Canada, particularly to savings and credit co-operatives and their members.

The Assurance-Vie Desjardins has had an impact in the insurance business through the development of many new policies, particularly in the field of social security and the protection of school children and students. Thus in 1953, the Assurance-Vie Desjardins came out with its family insurance and family protection plans. In 1945, it organized

[illegible] communities.

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a loan insurance and savings insurance department to promote popular savings in the caisses populaires. In 1958, the Assurance-Vie Desjardins offered its accident protection plans for school children and students. To further improve its service to the policyholders, the Assurance-Vie Desjardins acquired, in 1960, a Ramac IBM 305 electronic brain, the first to be used by a Canadian insurance firm. For the benefit of its younger policyholders, the Assurance-Vie Desjardins just recently set up (in April 1962) an accident prevention department. The purpose of this department is to analyze the statistics from claim files as a means of developing modern methods for the prevention of accidents in the schools, at play and in the homes. The Assurance-Vie Desjardins has thus placed its experience at the disposal of the general public, educators, government and private agencies. The latter have in fact been unanimous in commending this initiative and the community spirit shown by the company.

The Assurance-Vie Desjardins is known for the fine quality of its services, but it is also known in all social classes for its devotion to the cause of adult education. Over several years, it has sponsored educational broadcasts on television. For three years, millions of people have followed and enjoyed the series "Joindre les deux bouts", which was concerned with budgeting, and looked into the budgets of business concerns, governments and families. The educational value and usefulness of

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Ever since its inception, the Assurance-Vie Desjardins has concentrated on the co-operative sector of the economy, as evidenced by its services to the caisses populaires, its loans to co-operatives and its strong defence and promotion of co-operative institutions. The Assurance-Vie Desjardins is a member of the insurance committee of the International Co-operative Alliance, an organization devoted to the extension of the co-operative movement throughout the world and particularly in the emerging countries. For this purpose, the Alliance has set up a research sub-committee on which the Assurance-Vie Desjardins is represented by its director-general.

The Assurance-Vie Desjardins has been in existence for only thirteen years. Its rate of growth

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The Assurance-Vie Desjardins has been in existence for only thirteen years. Its rate of growth

has been one of the highest of all insurance companies in North America. On December 13, 1961, it had in excess of $800 million worth of insurance policies in force, and assets of $12½ million. Its contracts have become extremely popular, whether in the fields of individual or family coverage, life insurance on loans and savings, group insurance, accident and health insurance or accident insurance for school children and students.

The contribution of the Assurance-Vie Desjardins in the field of insurance has received recognition from many sources, and so has its concern for the social and cultural improvement of our people.

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S E C T I O N II

STRUCTURE, OPERATION AND

SERVICES

SECTION II

Structure, operation and services

1. ORGANIZATION AND ADMINISTRATION

a) Staff of the caisses populaires Desjardins

b) Crder of development according to the type of caisse populaire and to the region

c) Territorial jurisdiction of the regional unions of the Caisses populaires Desjardins

d) Consolidated balance sheets of regional or central "caisses" and affiliates

e) Composition of the three boards of regional unions

f) Composition of the board of directors of the Federation de Quebec des Unions regionales des Caisses populaires Desjardins

g) Composition of the executive committee of the Federation de Quebec des Unions regionales des Caisses populaires Desjardins

h) Description of duties of officers

i) Education and training.

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e) Clearing

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1 - ORGANIZATION AND ADMINISTRATION

(a) Staff of the Caisses popularies Desjardins

At December 31, 1961, out of 1,237 caisses populaires reporting, 1,202 were of the parochial type, 14 were of the occupational type and 21 were student caisses populaires. (The latter are not to be confused with the approximately 600 school savings schemes depositing funds with the parochial caisses populaires).

Development from 1935 to 1960

At December 31	Number of caisses populaires	Number of Members	Assets
1935	239	46,815	$ 10,555,087
1940	549	119,320	21,208,774
1945	904	371,211	119,089,459
1950	1,078	599,628	223,913,513
1955	1,132	852,325	402,282,088
1960	1,221	1,211,041	687,935,545

See statistics section, pages to for additional information.

(b) Order of development according to the type of caisse populaire and to the Region

The following table shows the French-Canadian popularion of the province of Quebec in 1959 (according to "Le Canada Ecclésiastiqe 1960"), the number of members for each region and the percentage of members of caisses populaires in relation to the total population.

1 - ORGANIZATION & ADMINISTRATION

(a) State of the caisses populaires movement

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The following table shows the French-Canadian population of the province of Quebec in 1959 (according to "le Canada Ecclésiastique 1960"), the number of members for each region and the percentage of members of caisses populaires in relation to the total population.

Unions	French-Canadian population	Number of Members	%
Trois-Rivières	359,744	143,753	40.0
Québec	782,784	314,694	40.2
Montréal	1,704,011	370,934	21.8
Gaspé	89,097	20,277	22.8
Sherbrooke	199,107	62,476	31.4
Rimouski	188,588	56,395	29.9
Chicoutimi	235,063	62,646	26.7
Ouest-Québécois	72,261	13,078	18.1
St-Hyacinthe	203,676	57,790	28.4
Joliette	93,335	35,022	37.5
Total:	3,927,666	1,137,065	29.0%

The caisses populaires in the Quebec and Trois-Rivières regions have reached or exceeded a 40 per cent membership among the French-speaking Catholic population. In western Quebec, the percentage is only 18.1 per cent. In Montreal, the ratio is only 21.8 per cent, a fact which partly explains the rapid growth of the caisses populaires located in that area, which is the most densely populated in the province of Quebec.

(c) Territorial jurisdiction of the Regional Unions of the Caisses populaires Desjardins

The regional unions have adopted the diocese as the basis of their territorial jurisdiction, except the unions of Trois-Rivières, Quebec and Montreal which include two or more dioceses.

Date of Foundation	Name of Regional Union	Territory of Jurisdiction
15-12-1920	L'Union régionale des Caisses populaires Desjardins de Trois-Rivières	Trois-Rivières, Nicolet.
17-12-1921	L'Union régionale des Caisses populaires Desjardins du district de Québec	Québec, Ste-Anne-de-la-Pocatière, Hauterive, Vicariat Apostolique du Labrador.
27-6-1924	L'Union régionale de Montréal des Caisses populaires Desjardins	Montréal, Valleyfield, St-Jean, Ottawa, Mont-Laurier, Timmins, St-Jérôme, Pembroke.
1-9-1925	L'Union régionale des Caisses populaires Desjardins du district de Gaspé	Gaspé
14-5-1934	L'Union régionale des Caisses populaires Desjardins de Sherbrooke	Sherbrooke
29-7-1937	L'Union régionale des Caisses populaires Desjardins du diocèse de Rimouski	Rimouski
1-8-1943	L'Union régionale des Caisses populaires Desjardins du diocèse de Chicoutimi	Chicoutimi
29-2-1944	L'Union régionale des Caisses populaires Desjardins de l'Ouest-Québécois	Amos
2-5-1944	L'Union régionale de St-Hyacinthe des Caisses populaires Desjardins	St-Hyacinthe
19-11-1944	L'Union régionale des Caisses populaires Desjardins de Joliette	Joliette

Development of Regional Unions from 1935 to 1960

At December 31	Number of Regional Unions	Number of Affiliated Caisses populaires	Assets of Regional Unions
1935	4	234	$ 1,045,951
1940	6	547	3,673,810
1945	10	904	15,651,328
1950	10	1,078	26,049,394
1955	10	1,132	54,312,041
1960	10	1,221	107,957,611

(d) Consolidated Balance Sheets of Regional or Central "caisses" and Affiliates

The statistics section, pages 154 to 191, shows the consolidated balance sheets of the regional or central caisses populaires and of the affiliated caisses populaires.

(e) Composition of the Three Boards of Regional Unions

The composition of the three boards of the Unions régionales des Caisses populaires Desjardins is shown in the second annex to this brief.

(f) Composition of the Board of Directors of the Fédération de Québec des Unions régionales des Caisses populaires Desjardins

GIRARDIN, Emile - President

President of the Caisse centrale Desjardins of Montreal - President Manager of the Union régionale de Montréal des Caisses populaires Desjardins - President of the Caisse populaire Notre-Dame de Grâce de Montréal.

PLOURDE, M.-Adélard, N.P. - Vice-President

President of the Union régionale des Caisses populaires Desjardins du diocèse de Chicoutimi - President of the Caisse populaire de St. Jérôme.

CARON, Jean-Jacques - 2nd Vice-President

Managing Secretary of the Union régionale des Caisses populaires Desjardins de Trois-Rivières.

VAILLANCOURT, Hon. Senator Cyrille - Managing Director

Managing President of the Caisse centrale des Jardins de Lévis - Managing President of the Union régionale des Caisses populaires Desjardins du district de Québec - Director of the Caisse populaire de Lévis.

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CARON, Jean-Jacques - 2nd Vice-President

Managing Secretary of the Union régionale des Caisses populaires Desjardins de Trois-Rivières.

VAILLANCOURT, Hon. Senator Cyrille - Managing Director

Managing President of the Caisse centrale des Desjardins de Lévis - Managing President of the Union régionale des Caisses populaires Desjardins du district de Québec - Director of the Caisse populaire de Lévis.

TURMEL, Emile, Abbé - Secretary

Secretary of the Union régionale des Caisses populaires Desjardins du district de Quebec.

RIVARD, Gérard - Director

President of the Union régionale des Caisses populaires Desjardins de Trois-Rivières - Vice-President of the Caisse populaire de Nicolet.

REMILLARD, Lucien - Director

Manager of the Caisse centrale Desjardins de Montréal - President of the Caisse populaire - St.-Jean de la Croix.

GAGNON, Olivier - Director

President of l'Union régionale des Caisses populaires Desjardins du district de Gaspé- Manager of the Caisses populaire de Cap Chat.

BERNARD, Adrien - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins du district de Gaspé.

BELLIVEAU, Fidèle - Director

President of the Union régionale des Caisses populaires Desjardins de Sherbrooke - Manager of the Caisse populaire Ste-Jeanne d'Arc de Sherbrooke.

UPONT, René - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins de Sherbrooke.

LEBEL, G.-Alex., N.P. - Director

Director of the Union régionale des Caisses populaires Desjardins du diocèse de Rimouski - Director of the Caisse populaire de Matane.

BOUCHARD, Georges-A. - Director

Vice-President of the Union régionale des Caisses populaires Desjardins du diocèse de Rimouski - Manager of the Caisse populaire de Rimouski,

[illegible] - [illegible]

Secretary of the Union régionale des Caisses populaires Desjardins du district de Gaspé.

RIVARD, Gérard - Director

President of the Union régionale des Caisses populaires Desjardins de Trois-Rivières - Vice-President of the Caisse populaire de Nicolet.

[illegible], Lucien - Director

Manager of the Caisse centrale Desjardins de Montréal - President of the Caisse populaire - St.-Jean de la Croix.

GAGNON, Olivier - Director

President of the Union régionale des Caisses populaires Desjardins du district de Gaspé - Manager of the Caisse populaire de Cap Chat.

BERNARD, Adrien - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins du district de Gaspé.

BELLIVEAU, Fidèle - Director

President of the Union régionale des Caisses populaires Desjardins de Sherbrooke - Manager of the Caisse populaire Ste-Jeanne d'Arc de Sherbrooke.

UPONT, René - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins de Sherbrooke.

[illegible] - Director

Director of the Union régionale des Caisses populaires Desjardins du diocèse de Rimouski - Director of the Caisse populaire de Matane.

BOUCHARD, Georges-A. - Director

Vice-President of the Union régionale des Caisses populaires Desjardins du diocèse de Rimouski - Manager of the Caisse [illegible]

Managing Secretary of the Union régionale des Caisses populaires Desjardins du diocèse de Rimouski.

PELLETIER, Robert - Director

President of the Union régionale des Caisses populaires de l'Ouest-Québécois - Manager of the Caisse populaire de Palmarolle.

PERRAULT, Maurice - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins de St-Hyacinthe - President of the Caisse populaires de Granby.

MACKAY, Napoléon - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins de St-Hyacinthe.

LEFEBVRE, Jean-Baptiste - Director

President of the Union régionale des Caisses populaires Desjardins de Joliette - Manager of the Caisse populaire de St-Thomas.

GRAVEL, Marcel - Director

Managing Secretary of the Union régionale des Caisses populaires Desjardins de Joliette.

HUDON, Guy. K.C. - Legal Adviser

(g) Composition of the Executive Committee of the Fédération de Québec des Unions régionales des Caisses populaires Desjardins

Messrs. GIRARDIN, Emile
CARON, Jean-Jacques
VAILLANCOURT, Hon. Senator Cyrille
TURNEL, Emile, Abbé
DUPONT, René
BOUCHARD, Georges-A.
GRAVEL, Marcel

(h) Description of Duties of Officers

The manager is the executive administrator of the caisse populaire. He carried out the decisions of the board of directors and of the credit committee of which he serves as secretary. He supervises the entire staff of the caisse, and distributes the work according to the size of the operation. In a large caisse populaire, there may be up to 20 employees. In such cases, there is an assistant manager, bookkeepers, etc. The distribution of duties varies according to the needs.

The president of the caisse populaire ranks above the manager, but as he may not draw a salary, he generally directs the caisse populaire from a distance. He may influence the general policies of the caisse populaire by personal interventions at appropriate times, and particularly at meetings of the board of directors and at general meetings of shareholders, at which he presides. In case of a tie, he has a second or casting vote.

The secretary is responsible for recording the substance of the discussions at the general meeting of shareholders and at the board of directors and for preparing the minutes. He may not draw a salary.

The same division of duties, with the necessary adjustments, exists in the regional unions or caisses régionales and in the Fédération des Caisses populaires Desjardins.

(i) Education and Training

A director of education and propaganda was

(h) Remuneration of [illegible]

The manager [illegible]

of the caisse populaire. He carried out the decisions of the board of directors and of the credit committee of which he serves as secretary. He supervises the entire staff of the caisse, and distributes the work according to the size of the operation. In a large caisse populaire, there may be up to 20 employees. In such cases, there is an assistant manager, bookkeepers, etc. The distribution of duties varies according to the needs.

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The same division of duties, with the necessary adjustments, exists in the regional unions or caisses régionales and in the Fédération des [illegible]

(i) Education and Training

A director of education and propaganda

appointed in 1960 to complete the organization of this department in keeping with modern techniques.

The Federation prepares a general plan for all the caisses populaires in the province. The regional unions adapt this plan according to the needs of their region and help the local caisses populaires to carry it out. The plan involves among other things an education and propaganda programme in each diocese, series of lectures and management training courses, meetings of presidents and managers and diocesan meetings or partial conventions.

Two series of courses were given in Quebec and Montreal during the winter of 1961-1962. They were attended by three hundred managers and approximately five hundred directors.

A large number of employees at lower levels have also regularly attended specially designed courses.

II - LEGISLATION, SUPERVISION AND PROTECTION

(A) LEGISLATION

The first caisse populaire was founded in Lévis on December 6, 1900, before legislation was enacted to govern it. It was only in 1906 that the Quebec Legislature voted the Quebec Co-operative Syndicates Act governing the caisses populaires.

In 1907 a bill was introduced in the Canadian parliament for the incorporation of caisses populaires under federal legislation. A special committee of the House of Commons was appointed to

[illegible] in 1950 to complete the organization of this movement in [illegible].

[illegible] a general plan for all [illegible]. The regional unions adopt this plan according to the needs of their region and help the local caisses populaires to carry it out. The plan involves among other things an education and propaganda programme in each diocese, series of lectures and management training courses, meetings of presidents and managers and diocesan meetings or partial conventions.

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In 1907 a bill was introduced in the Canadian parliament for the incorporation of caisses populaires under federal legislation. A special committee of the House of Commons was appointed to

consider the Co-operative Societies Bill. Mr. Alphonse Desjardins, Lord Grey, president of the International Co-operative Alliance and then Governor-General of Canada, as well as other distinguished persons appeared before the committee, which recommended that the bill be passed. It was voted by the House of Commons but rejected in the Senate, which, accepted with a majority of one vote the report of the standing committee on Banking and Commerce in which it was stated that such a bill was outside federal jurisdiction.

It will be noted with interest that the standing committee of the Senate on Banking and Commerce received objections to the effect that the bill was outside the jurisdiction of the Federal parliament. The minister of justice, the Hon. Mr. Aylesworth, expressed the following opinion:

> "In my opinion the subject with which the bill in question deals is within the legislative authority of any provincial legislature ..." (Debates of the Senate 1907-8, Vol. 2 page 1577).

This statement by the minister of justice also blocked other attempts to obtain federal legislation in 1910, 1911 and 1914.

Caisses populaires operating in the province of Quebec are governed by a provincial act, the Quebec Co-operative Syndicates Act.

The text of the Quebec Co-operative Syndicates Act will be found in the first annex to this brief.

[illegible]

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This statement by the minister of Justice has blocked other attempts to obtain federal legislation in this [illegible].

Caisses populaires operating in the province of Quebec are governed by a provincial act, the Quebec Co-operative Syndicates Act.

The text of the Quebec Co-operative Syndicates Act will be found in the first annex to this brief.

(B) SUPERVISION AND PROTECTION

1 - INSPECTION

(a) Historical Notes

The Federation, by bringing together in one institution the four (4) regional unions which existed in 1932, sought among other things to ensure that in the future, the inspection of the caisses populaires would be done by professionals and according to the same standards throughout the province.

A subsidy was granted by the government of the province of Quebec to assist in the task of auditing and supervising the caisses populaires. The first contract signed between the provincial government and the Federation of regional unions of the Caisses populaires Desjardins, on August 10, 1932, involved a subsidy of $20,000 to the Fédération des Caisses populaires Desjardins and official recognition, by the government of the province, of inspections carried out in the caisses populaires by the latter. This contract has been renewed several times since then, to the complete satisfaction of all parties.

Such action on the part of the government of the province of Quebec has the great advantage of unifying the authority which it officially recognizes to the Fédération des Caisses Populaires Desjardins, which is responsible for inspecting and supervising the caisses populaires.

(b) Professional Direction

In 1942, the Fédération des Caisses populaires Desjardins decided to appoint a director to its

inspection department. At the time, it had twleve (12) regular inspectors. In 1945, two assistants were appointed to the director of this department, and in 1945, a secretary was appointed.

1 - STAFF TRAINING

(a) Expansion of Staff

The rapid increase in the number of caisses populaires and the substantial growth of the assets and membership have created a serious staff shortage. Dozens of new inspectors have had to be hired and trained every year.

(b) Staff Training

The normal period of training and learning required to enable a new inspector to carry out his duties effectively is five years. Even university graduates (including chartered accountants and members of other recognized associations) must undergo this long period of training, in view of the great variety and complexity of the problems.

New inspectors who have not come up through the caisses populaires movement are first given training assignments of a week to a month in one or several caisses populaires in order to familiarize themselves with the act, regulations, procedure, bookkeeping methods, accounting, administration, etc. This assignment prepares and facilitates their professional training. Specialized inspectors then take over the training of the new inspectors, and work with them for a certain period of time.

The hiring of a considerable staff within

inspection department, [illegible] regular inspectors. In 19[illegible] [illegible] by [illegible] [illegible] was appointed.

3 - STAFF TRAINING

(a) Shortage of Staff

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The normal period of training and learning required to enable a new inspector to carry out his duties effectively is five years. Even university graduates (including [illegible] [illegible] [illegible] of other recognized associations) must undergo this long period of training, in view of the great variety and complexity of the problems.

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The [illegible] [illegible] [illegible] [illegible]

a relatively short time created a difficult problem of training and teaching, and a number of necessary measures were taken to cope with the situation:

1. Annual convention of inspectors;
2. Monthly seminars;
3. Quarterly meetings of officers;
4. Manual of instructions and accounting.

1. <u>Annual Convention of Inspectors</u>

Professional training may be acquired, of course, through daily contacts with more qualified colleagues; it may also be acquired through study, discussions, etc. These study conventions, lasting three or four days, were first restricted to the inspectors of the Federation, but were later extended to the inspectors and propagandists of the affiliated regional unions. Studies presented to a larger number of professionals made for more interesting discussions and provided better training.

This formula has proved very effective over a period of some fifteen years.

2. <u>Monthly One-Day Seminar</u>

For various reasons which would be too lengthy to discuss, the annual study convention was profitably replaced a few years ago by monthly seminars held in Quebec City and Montreal.

The programme varies from meeting to meeting. Subjects of current interest are submitted for study. Inspectors are divided into study groups of five or six, with one of the inspectors acting as chairman and secretary to note the decisions and report to the

general meeting on the conclusions reached by the group; after a general study and discussion, the draws the conclusions.

Two inspectors from the Quebec region usually attend the Montreal seminar, and two inspectors from Montreal attend the Quebec seminar. The inspectors are selected on rotation so as to give every inspector in the Quebec region an opportunity to meet the Montreal group, and vice-versa. The two guests take this opportunity to work for the whole week with their colleagues in the other region. This is a good way of enhancing the knowledge and practical experience of each individual inspector through direct contact with new and different problems. It also makes it possible to standardize working methods and procedures.

The director of the department and his colleagues attend these meetings but refrain as much as possible from participating in the discussions. Each month, a different inspector acts as chairman of the meeting and the secretary is also different. Thus everyone does his share of work.

3 - Quarterly Meetings of Officers

The rapid development of the movement and the constantly expanding staff place increasing responsibilities on the shoulders of the director of the inspection department and his colleagues. Teamwork is necessary to deal effectively with the many problems that arise.

The director meets with the two deputies, the two assistants, the officers in charge of the

permanent inspection of the central caisses and other senior inspectors according to the needs. The group is restricted to ten (10) members for purposes of efficiency. The meeting is chaired by the person designated by the group. The matters considered are varied and chosen among the most controversial. Thus an opportunity is provided for exchanging views on professional matters and for finding happy solutions to the problems of hiring, staff training, responsibility sharing, human relations and planning.

4 - Manual and Accounting and Instructions

The matters discussed at the 1945 convention of inspectors were again taken up at the 1950 convention and have served as a basis for the "Manual of Accounting and Instructions", which has been an important contribution to staff training. Thus the inspection department staff has been able to publish a manual containing a summary of the current operations of the caisses populaires in accordance with known and tried rules. The manual is used by employees and officers of the Federation, of the regional unions and of the caisses populaires.

It has rendered great services judging from the rising demand. It has become standard reference work for directors, officers and employees.

(c) Training School - Staff Exchanges

Successive training assignments under the direction of different colleagues for each programme, enable the inspection department to function as a real training school. Those qualified for audit work can

[illegible]
is restricted to ten (10) members for purposes of [illegible]
designated by the group. The matters considered are varied and chosen among the most controversial. Thus [illegible]

4 - Manual and Accounting and Instructions

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(c) Training School - Staff Training.

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and should be prepared for any situation that may arise within the movement. An inspector may gain special notice for his competence and personal ability and be appointed manager of a caisse populaire, a union or a regional caisse. Six inspectors have thus been appointed to the management of various regional unions, and twenty-three to the management of caisses populaires. For ten years, the Fédération des Caisses populaires Desjardins had as its president a former inspector of the caisses populaires.

The Federation has thus become a source of personnel for the benefit of caisses populaires faced with staff problems.

(d) Development and Improvement of Methods

It has been impossible in recent years to inspect increasing numbers of caisses populaires with assets rising annually without proportionately raising the number of inspectors, in the light of past experience. This is shown by the following statistics:

Year	Number: Inspectors	Number: Caisses	Number: Members	Number: Borrowers	Assets[1] (millions	Movement of Funds (mils.)
1932	4	165	40,933	12,363	$ 9	$ 25[2]
1937	5	371	67,297	15,605	17[3]	39
1942	10	650	137,528	35,056	46	133
1947	28	1,011	486,836	75,452	198	770
1952	35	1,118	693,258	106,290	326	1,418
1957	46	1,174	994,599	153,650	569	2,620
1961	63	1,239	1,294,082	204,808	897	4,200

1. Including the regional and central caisses.
2. Figures supplied by the Provincial Bureau of Statistics.
3. Figures supplied by the Federation's Statistics Department.

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Year	Inspectors	Caisses[1]	Members	Borrowers	Assets[1] (millions)	[illegible]	Thousands of [illegible]
[illegible]	4	163	47,95[illegible]	12,39[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	5	371	[illegible]	15,6[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	10	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	22	1,011	496,[illegible]	72,[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	35	1,116	593,35[illegible]	10[illegible],290	[illegible]	[illegible]	1,1[illegible]
1957	46	1,174	994,[illegible]	183,[illegible]	[illegible]	[illegible]	[illegible]
1961	5[illegible]	1,239	1,294,092	204,8[illegible]	[illegible]	[illegible]	[illegible]

1. Including the regional and central caisse.
2. Figures supplied by the Provincial Bureau of Statistics.
3. Figures supplied by the Federation's [illegible] department.

In itself, the greater number of caisses populaires would justify the increased number of inspectors. Much more is involved however, as all other items show very substantial increases, quite apart from the new services to be provided. More striking, perhaps, is the progression shown by averages with a percentage based on the 1932 figures:

Year	Number Inspector	Caisses	Average Assets per caisse Actual figures	Average Assets per caisse As a % of 1932	Average number of members per caisse Actual figures	Average number of members per caisse As a % of 1932
1932	4	165	$ 56,326 [1]	100%	244 [1]	100%
1937	5	371	40,354 [2]	72%	183 [2]	75%
1942	10	650	58,400	104%	288	118%
1947	28	1,011	174,453	310%	481	197%
1952	35	1,118	260,181	462%	625	256%
1956	44	1,160	400,192	710%	811	332%
1961	63	1,239	631,006	1,120%	1,046	429%

1. Figures supplied by the provincial Bureau of Statistics.

2. Figures supplied by the Federation's Statistics Department.

Despite this increasing development, it has been possible to ensure the effectiveness of inspection services and to protect the savings of the members and caisses populaires.

(e) <u>Hiring</u>

The recruitment of staff in wartime was not easy. Apart from the shortage of candidates, the financial resources of the Federation did not allow it to pay the salaries required to keep all the employees it would have hoped to keep on its staff.

Only a few years ago, the departure of one experienced inspector created a serious problem, as he

[illegible]

[illegible]

[illegible] ... however, to all

other items show very substantial increases, quite

apart from the new services to be provided. More striking

[illegible]

percentage based on the 1942 figures:

Year	Number of Inspectors	Number of Caisses	Average Assets per caisse: Actual	Average Assets per caisse: As % of 1942 figures	Average number of members per caisse: Actual	Average number of members per caisse: As % of 1942 figures
1932	4	165	$ 45,[illegible] [2]	100%	[illegible]	[illegible]
1937	5	371	40,35[illegible] [2]	72%	[illegible]	[illegible]
1942	1[illegible]	[illegible]	[illegible]	100%	[illegible]	[illegible]
1947	28	1,011	124,458	310%	[illegible]	[illegible]
1952	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1956	44	1,160	490,192	710%	[illegible]	[illegible]
1961	63	1,233	631,008	1,120%	1,046	[illegible]

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it would have hoped to keep on its staff.

Only a few years ago, the departure of one

experienced [illegible]

had to be replaced by a new employee. Today, in view of the greater number of experienced inspectors, it is easier to find a replacement. The problem of hiring adequate staff still remains difficult, however. The preference is given to commerce graduates who have majored in accounting, or to candidates with equivalent training either in public accounting, bank inspection, etc. Fifty per cent of the new inspectors come up through the ranks, that is to say from the local caisses populaires, from unions or from the regional caisses. This makes it possible to hire experienced people who will be useful in much shorter time than others, who may have a university degree, but are without practical experience.

2 - PRESENT STRUCTURE

(a) Improvement of the Service

The methods of inspection of the caisses populaires have been improved in the light of experience acquired over thirty years. The objectives of inspection are well defined, and go beyond book auditing. They are well in line with the thought so often expressed by the genial pioneer of the Raiffeisen banks in Switzerland, the Rev. Jean Evangéliste Traber:

- "Keep the law and the law will keep you".

These objectives may be summarized as follows:

1° - Auditing the books and documents in accordance with the usual professional techniques and procedures.

2° - Watching for infractions to the Act and

[illegible]

of the greater number of [illegible] it

is easier to find a replacement. The problem of hiring

[illegible]

preference is given to [illegible] graduates [illegible] have majored in accounting, or to candidates with four [illegible] [illegible]. Fifty per cent of the new employees come up through the ranks, that is to say from the [illegible] [illegible], from [illegible] or from the [illegible] schools. This makes it possible to hire experienced people who will be useful in work sooner than those others, who may have a university degree, but are without practical experience.

2 - [illegible]

(1) Improvement of [illegible]

The methods of inspection of the [illegible] population have been [illegible] in the light of experience acquired [illegible] years. The [illegible] of inspectors [illegible] defined, and [illegible] audit. They are [illegible] by [illegible] of the [illegible] in Switzerland, the [illegible]:

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

regulations.

3o - Analyzing the facts discovered to determine their causes and suggest corrective measures.

4o - Discussing inspection results with the officers of the society in order to:

(a) make them aware of their obligations;

(b) regularize anything that is not in order;

(c) make appropriate recommendations in the interest of all concerned.

5o - Preparing an inspection report describing the financial situation, and giving a summary of audits and samplings, results obtained and necessary recommendations.

The inspection procedure, without restricting the inspector's choice - which professionally is his sole responsibility - is as follows:

1 - Counting and checking the cash and valuables in hand.

2 - Reconciling the accounts of the régional caisses and of the banks and securing the necessary confirmations.

3 - Adding up the balances of individual accounts under capital, savings, loans and investments.

4 - Examining the vouchers, checking the entries in the shareholders' passbooks against entries in the individual accounts, sending confirmations of their balance to the shareholders and using other audit methods (checking, verifying additions, etc.) through intelligent samplings.

5 - Establishing the situation to date as reflected in the general accounts and cash book and comparing with the figures for the previous year.

6 - Verifying the loans granted against acknowledgements of debt, and controlling the sureties.

7 - Applying the same procedures for loans secured by a mortgage or otherwise.

8 - Analyzing outstanding loans or loans on which ayments are outstanding, and noting the dubious or bad loans.

9 - Verifying and analyzing the revenues and expenditures since the last inspection.

10 - Verifying and analyzing investments.

11 - Reading the minutes of general meetings and meetings of the board of management, supervisory board and credit committee, to see that there are no irregularities and that the decisions have been carried out.

12 - Giving the manager and staff instructions with regard to needed adjustments and to the adoption of improved practices.

13 - Holding a joint meeting of the members of the three boards or committees of the caisse populaire commission.

14 - Writing the inspection report according to prescribed forms. The annual inspection and any other inspection is, of course, always made without warning.

The inspection of the Caisses populaires

5 - Establishing the situation to date as reflected in the general accounts and cash book and comparing with the summary for the previous year.

6 - Verifying the [illegible] acknowledg-ments of debt, and controlling the sureties.

7 - Applying the same procedures for loans secured by a mortgage or otherwise.

8 - Analyzing outstanding loans or loans on which payments are outstanding, and noting the dubious or bad loans.

9 - Verifying and analyzing the revenues and expenditures since the last inspection.

10 - Verifying and analyzing investments.

11 - Reading the minutes of general meetings and meetings of the board of management, supervisory board and credit committee, to see that there are no irregularities and that the decisions have been carried out.

12 - Giving the manager and staff instructions with regard to needed adjustments and to the adoption of improved operations.

13 - Holding a joint meeting of the members of the [illegible] populaire commission.

14 - Writing the inspection report according to prescribed forms. The annual inspection and any other [illegible], are made without warning.

The inspection of the Caisses populaires

Desjardins compares favourable with any other inspection or audit, and is of the highest quality.

In 1952, the manager of the Federation stated in his annual report on the Federation's activities that "our inspection system is not too strict". Members of the staff of the caisses populaires need not take offence at this, he added, but we intend to resort to every conceivable and possible method of control. We harbour no prior suspicion as to the honesty of managers and employees of the caisses populaires, but we wish to remove even the temptation of embezzlement or fraud. As the saying goes, an ounce of prevention is better than a pound of cure. Many people would never yield to such a temptation if the occasion did not arise.

Inspection, to be really effective should be preventive. I should place much greater emphasis on preventing and temptations than on the discovery of serious and often irreparable offences.

(b) Present Structure

In 1960, with over 1,200 caisses populaires in operation, a combined membership of 1,200,000 shareholders and assets totalling $650,000,000, we had to redistribute the responsibilities and appoint two new assistants in the inspection department, to help the two previous ones who had been appointed deputies to the director of the department. A deputy and an assistant are employed in each of the Lévis and Montréal offices.

A team of inspectors are completing the

[illegible]

[illegible] position.

In 1952, the manager of the Federation stated in his annual report on the Federation's activities that "our inspection system is [illegible]. [illegible] of the staff of the caisses populaires need not take offence at this, he added, but we intend to resort to every conceivable and possible method of control. We harbour no prior suspicion as to the honesty of managers and employees of the caisses populaires, but we wish to remove even the temptation of embezzlement or fraud. As the saying goes, an ounce of prevention is better than a pound of cure. Many people would never yield to such a temptation if the occasion did not arise."

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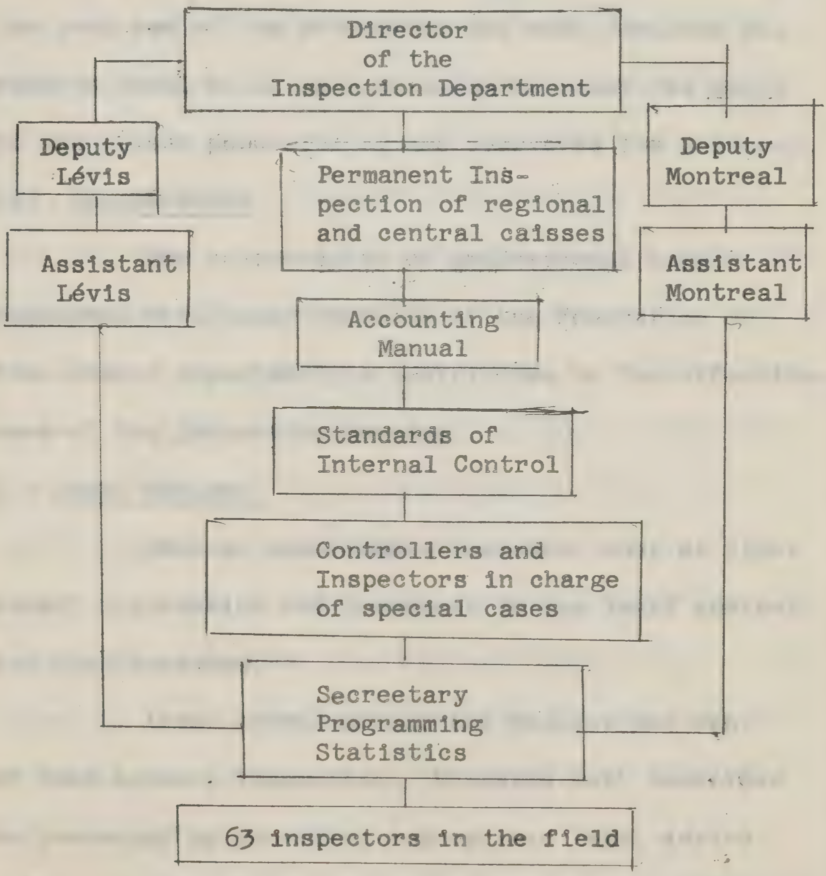
A team of inspectors [illegible]

accounting manual, and reviewing the manual of instructions and the standards of internal control.

We also have inspectors assigned to special jobs such as that of comptroller in cases where the funds of a caisse populaire are endangered by inadequate administration or as a result of unforeseen events.

The permanent inspection of the regional or central caisses is now an accomplished fact; it was a necessity in view of the increasing volume of operations.

The present structure of the inspection department is illustrated by the following organization chart:



Total Staff: 75 professionals in additionto the internal staff directly or indirectly connected with the inspection department.

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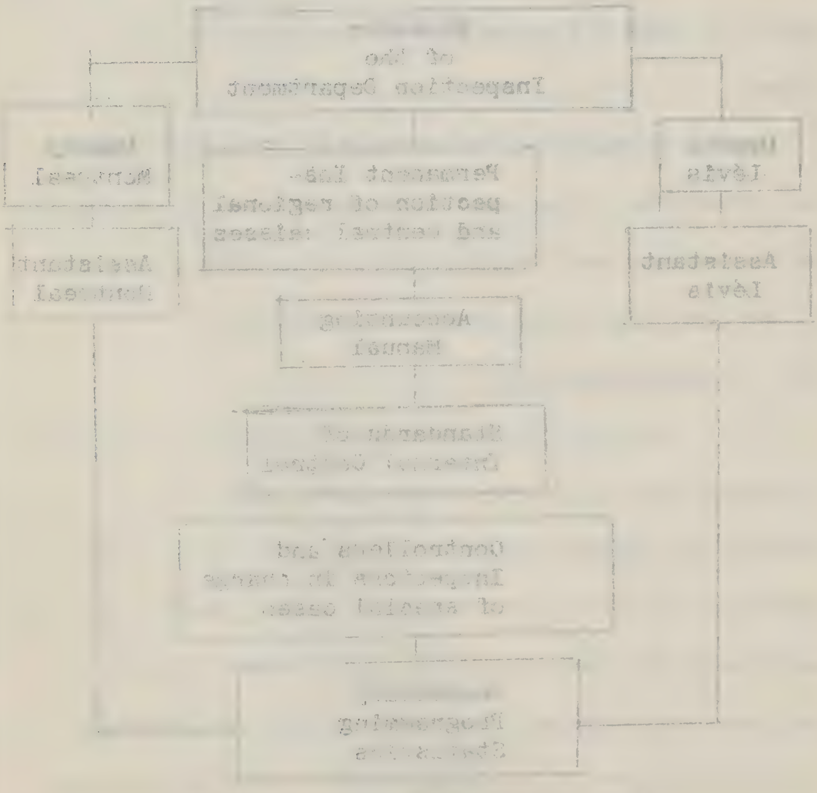

Total Staff: 75 professionals in additionto

Controllers-Inspectors

When a caisse populaire is threatened with losses due to an administrative error, a bad investment or dishonesty on the part of one of its employees or officers or for any other reason, the inspection dpeartment will, if required, supply a professional to assume temporary control of the caisse populaire or, if necessary, of the business concern which is indebted to the caisse populaire in order to help it reorganize and repay its loans, so that no loss will be sustained by the caisse populaire.

The controller-inspector, who is vested with adequate powers, must try to find proper solutions to the prob ems of the enterprise and must continue his efforts until it is in a position to repay its debts to the caisse populaire or has recovered its solvency.

(c) Co-operation

The co-operation of professional people connected with other services of the Federation or from sister organizations contributes to the effectiveness of the inspection service.

1 - Legal Adviser

Even an experienced inspector must at times submit information and documents to the legal adviser for consideration.

Legal consultations are frequent and many of them concern inspection. Mistakes must sometimes be prevented by providing appropriate legal advice before a particular transaction or operation. In other cases, a practical solution must be found to a situation

[illegible]

[illegible] and repay its loans, so that no loss will be sustained by the caisse populaire.

The controller-inspector who is vested with adequate powers, must try to find proper solutions to the problems of the enterprise and must continue his efforts until it is in a position to repay its debts to the caisse populaire or has recovered its solvency.

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1 - Legal adviser

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which may cause the caisse populaire a loss or other difficulties. There is also the interpretation of the Act and regulations, the settlement of conflicts, the collecting of loan payments, legal proceedings, etc.

While it is true that the invaluable services of a legal adviser extend far beyond the inspection department, it must be recognized that the effectiveness of inspection and the Federation's success in reaching a satisfactory settlement, usually out of court, of the many problems which have arisen are largely due to the high quality of professional services supplied by the legal adviser.

2 - The Regional Unions

An inspector-propagandist of the regional union is generally assigned the task of applying the necessary remedial measures in a caisse populaire, such as replacing a manager, teaching and training new employees, conducting checks to balance the books and improve the procedure in such a way as to facilitate the work of the staff or give effect to an inspection report from the Federation, particularly if the matter has been referred to him specifically, etc. In this work, the Federation enjoys the co-operation of the regional unions or regional caisses. Information is constantly exchanged to prevent any duplication. Some cases can be settled more easily by the regional union, which is in closer contact with the caisse populaire.

(d) Conclusion

The inspection department of the Fédération des Caisses populaires Desjardins is undoubtedly one of

the great security factors in the movement. It contributes to the protection of shareholders and depositors. It also protects the caisses populaires themselves and their leaders by ensuring the enforcement of the Act and regulations in accordance with the spirit of the founder, Commander Alphonse Desjardins. It provides for administration through the application of security rules for the safeguard and proper use of savings for purposes productive or beneficial to the shareholders.

Inspection is a professional appraisal which we try to carry out as thoroughly as possible. It is a responsibility of the Fédération des Caisses populaires Desjardins and is well accepted by the caisses populaires, which realize its necessity for the best protection of their savings.

2 - PROTECTION

(A) GENERAL PROTECTION

1 - Internal Control Standards

Along with the rapid development of the Caisses populaires Desjardins movement, there has been an increasingly rapid rise in the number of caisses populaires with a staff of several employees. This has created a need to consider problems of internal control. It became necessary to allocate the work adequately between the employees in order to clarify their respective responsibilities.

The object of internal control is to organize the distribution and carrying out of certain tasks

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2 - P R O T E C T I O N

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The object of internal control is to organize the distribution and carrying out of certain tasks

in such a way that two or more employees will be required to perform them. The system which leaves room for innumerable variations, is aimed at making embezzlement or theft by an employee more difficult if not impossible without the assistance of another employee. A parcel of money, for instance, must always be prepared by two employees who remain together throughout the operation. Each employee watches the other and their signature will serve to prove beyond any doubt that all of the money was placed in the parcel, which is protected by the usual seals. Similarly, a registered parcel containing money and (or) valuables will always be opened in the presence of two persons. If a shortgage is found, there will be two persons to certify the fact. Thus the honesty of the employee will be proved. On the contrary, if the parcel were opened by a single person, that person might be suspected of stealing the money even if not guilty. Lack of control is fatal. The above examples of internal control are well known to financial institutions.

An efficient distribution of duties according to the various functions of the employees makes internal control easier and also facilitates the work of daily control. Finally, a rational division of duties and the use of effective internal control standards are a necessary supplement to regular inspection, apart from their great usefulness for the general operation of the caisse populaire.

The work done in this field has already produced results which we hope to publish soon as a necessary

supplement to the accounting manual.

2 - Statistics and Office Machines

The statistics department of the Fédération des Caisses populaires Desjardins has been in existence since December, 1934. From that date, statistics from the affiliated caisses populaires have been compiled every six months, on June 30 and December 31 of each year, in order to provide needed information to the officers for the successful operation of the movement.

In June, 1957, the statistics department was equipped with IBM machines. Since then, statistics are compiled monthly and supplied to the officers and to all interested caisses populaires. As a means of helping the officers of local caisses populaires to manage their caisse more efficiently, the statistics department interprets their monthly report and translates it into some twelve control points; it also provides, for comparative purposes, the same control points weighted for the caisses populaires in their sector, in their area and for all the affiliated caisses populaires which indirectly make up the Federation. The complete list of control points is also supplied to each regional union manager to help him promote appropriate advice to the caisses populaires affiliated to his union.

A STUDY OF COMPARATIVE CONTROL POINTS

LA CAISSE POPULAIRE DE
Saint Ixte
Rimouski

NUMÉRO DE CAISSE		RAPPORT AU		
FÉDERATION	UNION REGIONALE	JOUR	MOIS	ANNEE
R 2345 U	987	28	2	61

CODE
* RAPPORT MENSUEL EN RETARD. LES CHIFFRES DONNES SONT POUR LE DERNIER RAPPORT REÇU
2 SECTEUR SEMI URBAIN
4 SECTEUR URBAIN
9 SECTEUR RURAL

[illegible]

[illegible]

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[illegible] STUDY OF COMPARATIVE CONTROL

LA CAISSE POPULAIRE DE
Saint [illegible]
[illegible]

R 2765 B | 98 | 28 2 61

Statistiques générales	À la fin du mois: Liquidité en pourcentage: En obligations	En caisse	Totale	Capital social vs épargne	Code	Au cours du mois: Variation de l'épargne: En %	En valeur: Diminution	Augmentation
Votre caisse	41.35 %	17.08 %	58.43 %	8.9 %		- .38 %	$ 9,811.83	$
Votre secteur	31.81 %	18.88 %	50.69 %	7.7 %	4	1.21 %		613,740.
Votre union	33.44 %	20.24 %	53.68 %	7.1 %		.58 %		482,284.
La Fédération	31.84 %	19.34 %	51.18 %	7.5 %		1.15 %		7,089,985.

Remarques :

Statistiques des prêts	À la fin du mois: Pourcentage des prêts totaux: En nombre: Sur rec. de dette	En nombre: Sur hyp	En valeur: Sur rec. de dette	En valeur: Sur hyp	Code	Au cours du mois: Taux de remboursement des prêts: Sur rec. de dette	Taux de remboursement: Sur hyp	Taux d'augmentation des prêts: Sur rec. de dette	Taux d'augmentation: Sur hyp
Votre caisse	33.5 %	66.5 %	3.7 %	96.3 %		11.55 %	1.69 %	8.23 %	1.25 %
Votre secteur	51.3 %	48.7 %	12.6 %	87.4 %	4	8.94 %	1.94 %	9.23 %	2.29 %
Votre union	55.8 %	44.2 %	18.4 %	81.6 %		7.75 %	1.96 %	8.63 %	2.17 %
La Fédération	59.9 %	40.1 %	16.9 %	83.1 %		8.31 %	1.86 %	10.62 %	2.36 %

Remarques :

LE SERVICE DE LA STATISTIQUE
LA FÉDÉRATION DES CAISSES POPULAIRES DESJARDINS

CONSERVEZ CE RAPPOR

3 - <u>All-inclusive Protection Policy</u>

All the caisses populaires affiliated to the regional unions within the Quebec Federation are required under the by-laws to take out insurance against theft from the Société d'Assurance des Caisses populaires Desjardins. The latter issues and all-inclusive protection policy for a minimum amount set by the Federation:

[illegible]

All the [illegible] populaires affiliated to the [illegible]

under the by-laws to take out insurance against theft from the Société d'Assurance [illegible] populaires Desjardins. The latter issues an all inclusive [illegible] line policy for a minimum amount set by the [illegible]:

Assets of the Caisse Populaire		Minumum Amount of Coverage
$	à $ 10,000	$ 2,000
10,001	20,000	2,250
20,001	30,000	3,000
30,001	40,000	3,800
40,001	50,000	4,600
50,001	60,000	5,400
60,001	70,000	6,100
70,001	80,000	6,900
80,001	90,000	7,600
90,001	100,000	8,500
100,001	110,000	9,100
110,001	120,000	9,800
120,001	130,000	10,100
130,001	140,000	10,600
140,001	150,000	11,000
150,001	160,000	11,300
160,001	170,000	11,800
170,001	180,000	12,200
180,001	190,000	12,600
190,001	200,000	13,000
200,001	210,000	13,400
210,001	220,000	13,800
220,001	230,000	14,200
230,001	240,000	14,600
240,001	250,000	15,000
250,001	260,000	15,400
260,001	270,000	15,800
270,001	280,000	16,200
280,001	290,000	16,600
290,001	300,000	17,000
300,001	350,000	18,400
350,001	400,000	19,600
400,001	450,000	21,000
450,001	500,000	22,200
500,001	600,000	24,800
600,001	700,000	27,400
700,001	800,000	30,000
800,001	900,000	32,400
900,001	1,000,000	35,000
1,000,001	1,200,000	40,000
1,200,001	1,400,000	45,000
1,400,001	1,600,000	50,000
1,600,001	1,800,000	55,000
1,800,001	et plus	60,000

This all-inclusive protection policy covers the caisse populaire against any loss resulting from:

1 - Any dishonest act committed by any of its employees either alone or in conjunction with others. The members of the three boards or committees of the caisse populaire are

also covered.

2 - Burglary, theft, house breaking, armed robbery, petty theft and damage or destruction resulting therefrom.

3 - Burglary, theft, house-breaking, armed robbery, petty theft within Canada under the custody of any of its employees or of any other person appointed as its agent under a resolution of the board of management, or of any person employed in a railway express department or in the Canadian Post Office.

4 - Any damage except damage caused by fire to the premises, furniture, office equipment, safes, strong boxes, vaults or security boxes, caused by burglary, theft, house-breaking, armed robbery, petty theft, or attempts at such actions, when the insured party is the owner of the said goods or objects or is legally responsible for their custody.

5 - Forgery or alternation of or upon any trade bill or document in connection with the signature of the insured party or of a shareholder only, in the capacity of payer or beneficiary, or in connection with an increase in the payable amount, as a result of which the insured party was induced, while the policy was in force, to extend any credit or give out anything of value.

6 - Burglary, theft, house-breaking, armed robbery, petty theft and their risks (except the risk

of theft by employees of the senders or addressees) in connection with the use of registered mail or express service, to send money or negotiable assets in which the insured party has an interest, financial or otherwise, while the said property is in transit within Canada.

A caisse populaire may raise the amount of its protection under one, several or all items as necessary.

4 - Floating Security Bond

In addition to the all-inclusive protection policy, the Fédération des Caisses populaire Desjardins maintains for the benefit of the affiliated caisses populaires a $10,000 floating security bond covering every employee and officer of all caisses populaires which are members of the affiliated regional unions.

5 - Security Bond

In 1948, the Fédération des Caisses populaires Desjardins set up a security fund, the object of which is to give added protection to an affiliated caisse populaire in the event of loss arising from theft, embezzlement or a bad loan, over and above the amount of the all-inclusive protection policy or of the reserves proper of the ciasse populaire.

Loans from the security fund are granted on the condition that such financial assistance will enable the caisse populaire to remain in operation, while refunding the loan on a long term basis and paying a small interest from its future net surpluses.

[illegible]
[illegible]
[illegible]
[illegible] party has an interest, financial or otherwise, while the said property is in transit within Canada.

A caisse populaire may insure the amount of its production under one, several or all items as necessary.

4 - Blanket Security Bond

In addition to the all-inclusive protection policy, the Fédération des caisses populaires Desjardins maintains for the benefit of the affiliated caisses populaires a $10,000 blanket security bond covering every employee and officer of all caisses populaires which are members of its affiliated regional unions.

5 - Security Fund

In 1940, the Fédération des caisses populaires Desjardins set up a security fund, the object of which is to give added protection to an affiliated caisse populaire in the event of loss arising from theft, embezzlement or a bad loan, over and above the amount of the all-inclusive protection policy or of the reserves proper of the caisse populaire.

Loans from the security fund are granted on the condition that such financial assistance will enable the caisse populaire to remain in operation, while refunding the loan on a long term basis and paying a small interest from its future net surpluses.

At March 31, 1962, the assets of the security fund stood at $708,379.58 as shown in the following financial statement:

ASSETS AT MARCH 31, 1962

INVESTMENTS: (Nominal value: $460,000 $456,238.90

LOANS:	DATE	RATE	ORIGINAL AMOUNT	PAYMENT IN 1961-62	BALANCE
Normandin	(C) 23-12-52	1%	$ 20,500.00	$ 125.00	$18,667.21
St-Urbain	(Q) 28-1-53	1%	5,000.00	957.72	ø
St-Alphonse de Rodriguez	(J) 9-6-53	½ de 1%	33,000.00	500.00	29,000.00
St-Ls de l'Ile aux Coudres	(Q) 10-2-55	½ de 1%	7,000.00	200.00	5,800.00
St-Roch d'Orford	(S) 2-5-55	1%	9,367.03	2,000.00	5,367.03
Ste-Marguerite de Lingwick	(S) 31-1-55	1%	10,000.00	ø	10,000.00
New-Richmond	(Q) 23-1-59	½ de 1%	15,127.78	65.00	14,762.78
			TOTAL:	$ 3,847.72	$83,597.02

SINKING FUND				
St-Andre de Restigouche	(R) 15-8-58	$ 18,500.00	$ 1,850.00	$12,950.00
Clericy	(OQ)31-12-59	27,743.14	2,500.00	22,500.00
		TOTAL:	$ 4,350.00	$35,450.00

GRAND TOTAL: 119,047.02

CASH IN HAND: (On deposit C.C.D.L.) 134,043.66

TOTAL ASSETS: $709,379.58

All caisses populaires affiliated to the regional unions in the province contribute to the security fund, except those affiliated to the Montreal regional union which separately operates and administers a similar fund with assets of $172,622.40 at August 31, 1961, of which an amount of $47,745.97 was on loan.

as March 31, 1962, the assets of the security fund stood at $703,379.58 as shown in the following financial statement:

ASSETS AT MARCH 31, 1962

INVESTMENTS (Municipal Bonds) [illegible]

NAME	DATE	RATE	AMOUNT	IN SINKING FUND	BALANCE
Bonaventure	(C) 23-12-53	4%	$ 20,500.00	$ 1[illegible].00	$19,667.21
[illegible]	(G) 28-1-61	4%	6,300.00	957.?2	[illegible]
St-Alphonse-de-Rodriguez	(J) 9-6-53	½ de 1%	33,000.00	300.00	[illegible]
St-La de l'Ile aux coudres	(Q) 10-2-55	½ de 2%	7,000.00	200.00	[illegible]
St-Roch d'Orford	(S) 2-5-56	2%	9,457.03	3,000.00	[illegible]
Ste-Marguerite de Lingwick	(S) 31-1-55	2%	10,000.00	[illegible]	[illegible]
New-Richmond	(G) 22-1-57	½ de 1%	15,167.78	[illegible]	[illegible]
			TOTAL:	$ [illegible]	[illegible]

SINKING FUND

NAME	DATE	AMOUNT	IN SINKING FUND	BALANCE
St-Anne de Restigouche	(R) 15-8-58	$ 18,500.00	$ 1,420.00	$12,[illegible]
Clerley	(Q) 31-12-59	27,143.14	2,500.00	2,500.0[illegible]
		TOTAL:	$ 4,[illegible].00	[illegible]

GRAND TOTAL: 117,[illegible]

CASH IN HAND: On deposit C.C.D.L. [illegible]

TOTAL ASSETS: $703,379.58

All caisses populaires affiliated to the regional unions in the province contribute to the security fund, except those affiliated to the Montreal regional union which separately operates and administers a similar fund with assets of [illegible] as at March 31, 1962 of which an amount of $4[illegible],[illegible]45.97 was on loan.

The security fund is supplied by a 10 per cent deduction on annual contributions paid by the caisses populaires to their regional union. This amount is paid to and administered by the Fédération des Caisses populaires Desjardins.

(B) PHYSICAL PROTECTION

1 - Safes and Vaults

The Société d'Assurance des Caisses populaires Desjardins is constantly conducting laboratory analyses with distinguished metallurgists specialized in this field, to discover the most effective protective equipment against burglary. Approval is given for the purchase of only the finest equipment: vault doors, safes of all kinds, burglar-proof chests, strong boxes, etc. As soon as a caisse populaire has reached a certain degree of development, it is asked to equip the doors of vaults and safes with a regular or delayed action time lock. An increasing number of caisses populaires are equipped with special doors with delayed action burglar-proof time lock. Vaults are built according to the specifications of the Sociétéd'Assurance des Caisses populaires Desjardins which are much more exacting than those of the Canadian Underwriters Association. The walls must have a minimum thickness of 15 to 18 inches and be made of concrete with a 6,000 pound pressure resistance and first quality steel reinforcement.

The caisses populaires and the regional caisses are often approached by the Fédération des Caisses populaires Desjardins, the regional unions, the inspectors

[illegible]

cent [illegible]

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[illegible]

and the Société d'Assurance des caisses populaires and urged to improve their protective equipment if necessary.

2 - Alarm Systems

The best of electronic alarm systems are of current use in the main offices. Most other caisses populaires use a wide variety of proven systems with satisfactory results.

3 - Armed Guards and Special Investigators

Over 100 caisses populaires have armed guards who keep constant watch over the office during business hours. The guards are adequately protected and carry the necessary weapons. They are specially trained for the job.

The Sociéte d'Assurance des Caisses populaires Desjardins also has special investigators or detectives who are constantly on the alert to prevent attacks or to lend a hand anywhere in the province in case of need. They co-operate closely with regular police forces.

These supplementary protective measures have become necessary in view of the unhappy experience of the past few years.

The Caisses populaires Desjardins have an excellent system of protection against all types of robbery, if not the best.

III - Assets

The policy of the Caisses populaires Desjardins concerning loans and investments is usually the same notwithstanding the size or the location of the

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The best of electronic alarm systems are of current use in the main offices. Most other caisses populaires use a wide variety of proven systems with satisfactory results.

3 - Armed Guards and Special Investigators

Over 100 caisses populaires have armed guards who keep constant watch over the office during business hours. The guards are adequately protected and carry [illegible]. They are [illegible] for the job.

The Société d'Assurance des Caisses populaires Desjardins also has special investigators or detectives who are constantly on the alert to prevent attacks or to lend a hand anywhere in the province in case of need. They co-operate closely with regular police forces.

These [illegible] have become necessary in view of the unhappy experience of the past few years.

The Caisses populaires Desjardins have an excellent system of protection against all types of robbery, if not the best.

III - Assets

The policy of the Caisses populaires Desjardins concerning loans and investments is usually the same notwithstanding the size or the location of the

caisse populaire.

(a) Loans

Assuming that the risks are equal, priority is always given to small loans. The caisse populaire therefore deals primarily in small personal loans. If it has sufficient financial resources, it grants larger loans, either against a "reconnaissance de dette" or a mortgage.

Loans to the shareholders usually represent 50 per cent of assets. In the average caisse populaire, the loans are distributed on the basis of approximately 1/3 personal loans against a "reconnaissance de dette" and 2/3 mortgage loans. With the development of the caisse populaires, the total amount allocated to small loans gradually drops in relation to the assets, and conversely, the portion used for mortgage loans or loans to institutions rises considerably. See the section on statistics, page 151 - 154.

(b) Investments

Bond investments are an important part of the general liquidity of the caisses populaires which is presently set at 50 per cent of liabilities. Bond holdings usually represent 35 per cent of assets. The size of loans in relation to assets is shown in the statistics section, pages 151 to 154.

The amount of the assets varies according to the amounts paid on shares and deposited in savings accounts, to which are added the reserves proper of the caisse populaire. See the statistics section - position of local caisses populaires - page 154 - 185.

(a) Loans

[illegible] is always given to small loans. The caisse populaire therefore deals primarily in small personal loans. If it has sufficient financial resources, it grants larger loans, either against a "reconnaissance de dette" or a [illegible].

Loans to the shareholders usually represent [illegible] the loans are distributed on the basis of approximately [illegible] and 2/3 mortgage loans. With the development of the caisse populaires, the total amount allocated to small loans gradually drops in relation to the assets, and conversely, the portion used for mortgage loans or loan [illegible] on the tables, page 191 - 194.

(b) Investments

Bond investments are an important part of the general liquidity of the caisses populaires which is presently set at [illegible] per cent of liabilities. Bond holdings usually represent [illegible] per cent of assets. The size of loans in relation to assets is shown in the [illegible].

The amount of the assets is [illegible] according to the amounts paid on shares and deposited in savings accounts, to which are added the reserves proper of the caisse populaire. See the statistics section - [illegible] caisses populaires - page 194 - 195.

I - CASH ON HAND AND LIQUID RESERVES

(a) A Study of Percentage Ratios

The immediate liquidity, commonly known as the cash liquidity, is maintained at 1 per cent of liabilities and distributed as follows:

10 per cent on deposit with the regional or central caisse, 5 per cent cash on hand including cheques and payment orders drawn on other institutions.

See statistics section - Series X - pages, 185, 187 and 189.

(b) Money in Hand

The money in hand included in the cash liquidity may be greater or smaller according to the transactions of the shareholders. Any surplus is deposited with the regional or central caisse, or exceptionally with a chartered bank or trust company.

The cash liquidity is increased when deposits (capital and savings) of the shareholders are greater than the withdrawals, when the repayments by the borrowers are greater than the amount of loans granted, and (Or) when the cashing on maturity bonds or the possible sales of bonds held in the portfolio is greater than purchases.

The caisse populaire then has a choice, inasmuch as the general liquidity is adequate and according to the volume of acceptable loan applications, between

1 - loaning to the shareholders or

2 - investing in bonds

Conversely, the liquid assets drop when

[illegible]

(a) [illegible]

The immediate liquidity, currently shown as the cash liquidity, is maintained at [illegible] per cent of [illegible]

10 per cent on deposit with the regional or central caisse. 5 per cent cash on hand [illegible] to other institutions.

See statistical section - Series [illegible] - pages 153, 157 and [illegible]

(b) Money in hand

The money in hand included in the cash liquidity may be greater or smaller according to the transactions of the shareholders. Any surplus is deposited with the regional or central caisse, or exceptionally with a chartered bank or trust company.

The cash liquidity is increased when deposits (capital and savings) of the shareholders are greater than the withdrawals, when the repayments of the borrowers are greater than the amount of loans granted, and (or) when the [illegible] on maturity bonds or the [illegible] purchases.

The [illegible], in [illegible] as the general liquidity is adequate and according to the volume of acceptable loan applications, between [illegible]

2 - Investing in [illegible]

[illegible]

withdrawals (capital and savings) of the shareholders are greater than the deposits, when bond purchases are greater than maturing bonds or bond sales.

The caisse populaire must then protect its general liquidity and also the cash liquidity by the following usual methods:

1 - activate the recovery of current loans;

2 - stop loaning large amounts as a first step;

3 - stop loans completely if necessary;

4 - stop purchasing bonds, even with the proceeds from maturing bonds;

5 - sell bonds or borrow against bonds if the sale of such bonds involves a heavy loss of capital.

(c) General Liquidity

The required liquidity is determined by the Fédération des Caisses populaires Desjardins, accordance with its affiliated regional unions. Changes in liquidity standards are rather unusual, as we are more interested in helping and protecting the shareholders than in making profits.

The percentage of liquidity has been as follows:

Up to the second World War - 3 per cent.

From the end of the second World War (1946) to date - 50 per cent.

Prior to 1960, liquidity was determined on the basis of assets. Since 1960, it has been based on liabilities less loans, the loans being deducted from the cash liquidity or from investments.

However, regional unions are free to adjust the liquidity ratio according to particular cases.

Without changing the official percentages, the authorities often stress the need for caution in the Revue Desjardins and in circular letters. Inspection reports always point out in fractions to the liquidity rules. Steps are taken to ensure that the caisses populaires maintain the required liquidity.

2 - INVESTMENTS

(a) General Criteria

General criteria must take account of the bonds authorized by the Act. They are aimed at ensuring a strong percentage of easily negotiable securities..

As a result, the portfolio of a caisse populaire almost invariably includes Government of Canada bonds and province of Quebec bonds. These are followed by bonds issued by municipalities, cities and towns and school boards, and finally, bonds issued by "fabriques", hospitals and religious orders.

The purpose of the second distribution is to promote the purchase of short-term bonds, which are more easily realized in periods of tight money. Moreover, there is the assurance that the capital will be completely refunded at maturity, whereas it is not always possible to keep a long-term bond; selling in unfavourable market conditions may cause considerable losses. The caisses populaires are increasingly investing in Government of Canada treasury bills.

Maturity dates on the bonds purchased are spread over a maximum period of ten years; it is only

in exceptional circumstances that the ten-year term may be somewhat extended.

Finally, a caisse populaire is not allowed to purchase longest term bonds from an issue when a substantial amount is to become payable at that date, thus making a re-financing necessary. As we cannot know what market conditions will be ten years hence, we do not make such purchases.

(b) Liquidity of Investments

1 - By category:

Suggested Distribution

1 -	Canada	15%	
	Province of Quebec	15%	30%
2 -	Municipalities, cities, towns, school boards		50%
3 -	Fabriques, Hospitals, religious orders		20%
			100%

Present Distribution

(a) Caisses populaires

Hereunder is the distribution of investments made by the caisses populaires affiliated to the Montreal and Chicoutimi regional unions at the end of the fiscal year 1961. The two regional unions then included approximately 40 per cent of all caisses populaires, and their affiliates held 40 per cent of the total portfolio of local caisses populaires:

Bonds	Value	Percentage
Government of Canada or guaranteed by same	$ 7,768,450	8.8%
Province of Quebec guaranteed by same	10,922,400	12.4%
Municipalities and school boards	60,843,815	68.9%
Religious orders and non commercial institutions	8,735,600	9.8%
	$ 88,270,265	100.0%

(b) National or Central "caisses"

Distribution of Investments in ten (10) Regional or Central caisses at the end of their Fiscal Year 1961

Bonds	Value	Percentage
Government bonds	$ 100,000	0.2%
Government of Canada or guaranteed by same	11,752,489	21.7%
Province of Quebec or guaranteed by same	14,780,061	27.3%
Municipalities and school boards	20,763,870	38.4%
Religious orders and non commercial institutions	6,659,970	12.3%
Other institutions	60,312	0.1%
	$ 54,116,702	100.0%

2 - By Date of Maturity

Suggested Distribution

dans 1 an	10%	
" 2 ans	10%	
" 3 "	10%	
" 4 "	10%	
" 5 "	10%	avant 5 ans 50%
dans 6 ans	10%	
" 7 "	10%	
" 8 "	10%	
" 9 "	10%	
" 10 "	10%	6 à 10 ans 50%
Total:	100%	100%

Present Distribution

(a) Caisses populaires

In referring to the liquidity of investments, we place much weight on the distribution of maturity dates for such investments.

As an example, the following table shows the maturity dates of investments, at August 31, 1960, in the 278 caisses populaires affiliated to the Montreal regional union.

Maturity date	Value	Percentage	
De sept. à déc. 1960	$ 6,078,000	9.0%	
en 1961	9,133,275	13.5%	
1962	10,215,325	15.1%	
1963	9,101,425	13.4%	
1964	7,164,425	10.6%	
1965	6,727,375	9.9%	
1960 - 1965			71.5%
1966 - 1970	14,232,775		21.0%
1971 et plus	5,101,600		7.5%
TOTAL:	$ 67,754,200		100.0%

(b) Regional or Central Caisses

An analysis of the investment portfolio of ten (10) central caisses at the end of their 1961 fiscal year showed the following maturity terms:

Maturity Term	Value	Percentage
de 1 à 5 ans	$ 35,863,129	66.0%
de 6 à 10 ans	13,505,017	24.9%
de 11 ans et plus	4,962,871	9.1%
TOTAL:	$ 54,331,017	100.0%

(c) Direct Acquisitions

Bond transactions, purchases and sales are generally made through brokers. Local caisses populaires, however, will in most cases negotiate such transactions through their regional caisse. Direct bond purchases are scarce and always for relatively small amounts. They usually concern issues from institutions remote from centres where there is a caisse populaire, but which are hard to sell on the market. Besides, marketing cost would be prohibited. The local caisse populaire makes an agreement with the regional or central caisse to share the bond issue.

(d) Sale before Maturity

Sales of bonds before maturity are relatively infrequent. Caisses populaires do not speculate, and exchanges sometimes produce more disappointment than profit. However, circumstances sometimes make it necessary to sell bonds to realize the money. Such sales are almost invariably transacted through the regional or central caisse. There may also be exchanges of low interest bonds, to be replaced with other bonds with a better yield or more readily negotiable. An immediate loss of capital is sometimes written off by a net gain from a current rate of interest.

It is the general policy to purchase bonds and keep them until maturity, even if they have to be used temporarily as collateral for a loan.

In the year 1961, investments redeemed for cash in the local caisses populaires only amounted to $40,924,000.

(b) [illegible]

Bond transactions, purchases and sales are generally made through brokers. Local caisses populaires, however, will in most cases negotiate such transactions [illegible]. [illegible] purchases are scarce and always for relatively small amounts. They usually concern issues from institutions remote from centres where there is a caisse populaire, but which are hard to sell on the market. Besides, marketing cost would be prohibited. The local caisse populaire makes an agreement with the regional or central caisse to share the bond issue.

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It is the general policy to purchase bonds and keep them until maturity, even if they have to be used temporarily as collateral for a loan.

In the year 1961 investments redeemed for cash in the local caisses populaires only amounted to $10,924,000.

e) Investments Authorized by Law

Under Section 40 of the Quebec Co-operative Syndicates Act, caisses populaires are authorized to purchase the following types of bonds:

Government of Canada

Province of Quebec

Fully guaranteed by the government of Canada or the Province of Quebec

or within the province of Quebec:

municipalities

school corporations

construction or repair of churches presbyteries or cemeteries

"fabriques"

ecclesiastical or religious corporations

Investments in real estate within the province or on a first privilege or first hypothec to an amount not exceeding three-fifths of the municipal evaluation of the real estate affected.

This section of the Act has made it possible to ensure the security of savings thus invested.

f) Prior Authorization from the Federation

The purchase of bonds is the responsibility of the board of management of the caisse populaire or of the regional or central caisse, as the case may be. However, investments can be made only with the prior approval of the Federation.

This requirement is of primary importance. For the majority of directors of caisses populaires, investments are difficult to appraise. Even those among

e) Investments authorized by law

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them who have the theoretical training needed do not always have the practical knowledge specifically required in a given instance.

The Federation therefore examines the various types of bonds that are contemplated. Its study covers the following points:

1 - Legal permissibility

a) class allowed under the law

b) legal borrowing powers of borrowing corporations

c) regularity of the fiduciary instrument and of the issuing and borrowing procedure.

2 - Solvency

a) analysis of present financial statements

b) comparative study of financial statements

c) study of prospectus

d) guarantees - moral
hypothecary
governmental

e) reimbursement capacity

3 - Maturity

a) series or sinking fund bonds

b) arrangement: annual amount
length of term

c) large amount due on ultimate date of maturity

4 - Rate of coupon

5 - Yield

6 - Price

7 - Balance of individual portfolio

The Federation may then approve the purchase with or without changes. This precautionary measure has been invaluable in the past and remains in very useful

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[illegible]

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b) arrangement: annual amount
length of term

c) large amount due on different date of maturity

4 - Rate of coupon

5 - Yield

6 - Price

7 - Balance of individual portfolio

The Federation may then approve the purchase with or without changes. This [illegible] has been invaluable in the past and remains so very useful

protection. In addition to ensuring an excellent selection of securities, it allows the caisses populaires to save on the purchase price.

g) <u>Relations between caisses populaires and brokers</u>

Business relations between stock brokerage firms and caisses populaires are rather limited, as the majority of caisses populaires purchase bonds from their regional caisse; through bulk purchasing, they are able to buy excellent securities at attractive prices.

The regional or central caisses purchase from the brokers practically all the bonds needed by their caisses populaires and by themselves.

h) <u>Accounting practices</u>

Bonds are entered in the books at cost. If the purchase price is above par, the surplus is gradually amortized over the years remaining before maturity, in order that the security will then be listed at part in the books.

If the purchase is made below par, it is entered in the books at the price paid, and the prifit is recorded only when the bond matures or at the time of sale, if any. If the value of the security holdings rises or drops with the market, this is not recorded in the books because most bonds are kept to maturity to avoid an accounting problem (which would not be too serious in some institutions managed by professionals) which is useless in our type of organization. However, when the market slackens, some of the larger caisses populaires set up a reserve from part of the annual net surpluses to absorb the depreciation of securities.

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Should the need arise for a caisse populaire to obtain cash, it will generally prefer to borrow from the regional caisse rather than to sell securities at a loss. It is a very short-term loan. By taking the necessary action, the caisse populaire will be able to repay its loan to the regional caisse and resume possession of its bonds until maturity.

Finally, most of the caisses populaires do not capitalize the interest accrued on investments at the end of the fiscal year; this constitutes a kind of supplementary reserve. On the other hand, the regional caisses whose portfolio mainly consists of investments capitalize the accrued interest on bonds at the end of the fiscal year.

3 - PERSONAL AND MORTGAGE LOANS

"The guarantees of repayment being equal, small loans are to be preferred to larger ones" (article 36 of the by-laws).

On the basis of this by-law, loans are rationed in periods of tight money. Large loans are curtailed first, and if this is not enough to protect the cash position, loans are cut off entirely.

Personal loans granted against an acknowledgement of debt with or without surety to the same shareholder are limited to an amount set by the general meeting of shareholders. For larger loans, moveables (membership shares, savings, legally authorized bonds, agricultural collateral) must be given as security. The

[illegible]
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limit does not apply to mortgage loans or to loans granted to public bodies such as municipalities and school boards, or to "fabriques" or religious orders, or to co-operative societies.

The position of the caisses populaires at December 31, 1960, as shown in the statistics section, page , indicates the balance due on loans by the various public bodies.

The favoured categories of borrowers and the size of loans granted against acknowledgements of debt or against mortgages, are indicated in the statistics section, pages , and .

a) Purposes of Objects of Loans

The caisses populaires are "the true banks of the people (see the brochure on the 'caisse populaire', by Alphonse Desjardins) where the honest, industrious, sober, thrifty worker and farmer can obtain the funds they need to finance their activities, set up a home, free themselves of a heavy debt, make necessary cash purchases", etc.

Unfortunately, we have no statistics showing the use of loans according to their object. In the spirit of the founder, loans are made for purposes productive or advantageous to the borrowers. "Never, in any circumstance, wrote Commander Alphonse Desjardins, should a caisse populaire loan for an unproductive expense". The caisse populaire must loan "to help its members and make them more prosperous."

b) Evaluation of possible losses

The moral credit of small people is excellent,

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b) Evaluation of possible losses

The moral credit of small people is excellent

particularly when they take out a loan from their own caisse populaire. The percentage of delayed repayments is very small in relation to the total amount of loans. Delays are perhaps more frequent in the rural caisses populaires, in view of the irregularity of agricultural income, which is subject to the whims of nature and to market conditions; but the danger of loss is practically inexistent.

On the whole, borrowers faithfully meet their obligations; that is why the caisses populaires do not set aside a special reserve for doubtful or bad loans; losses being scarce and quite small, they are absorbed from the annual net surpluses.

The following table shows the number and amount of losses sustained on loans by the caisses populaires in the main years studied by the commission. The loss statistics given here are based on a special questionnaire filled by 65 per cent of the caisses populaires holding 85 per cent of assets as at December 31, 1961:

Year	Number of losses	Value of losses	Loans granted during the year
1940	15	$ 4,550	
1945	6	2,861	
1950	6	2,052	$ 52,288,680 (1)
1951	18	16,950	58,521,774 (1)
1952	18	9,014	65,430,562 (1)
1953	19	39,640	80,602,938 (1)
1954	20	12,736	79,689,195 (1)
1955	20	18,289	97,115,354 (1)
1956	39	28,825	119,151,104 (1)
1957	41	23,272	117,370,616 (1)
1958	33	31,175	129,568,909 (2)
1959	70	23,650	143,987,057 (2)
1960	63	25,307	126,525,147 (2)
1961	52	14,538	178,929,133 (2)

particularly [illegible]
[illegible]. The percentage of delayed repayments
[illegible]
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The following table shows the number and amount of losses sustained on loans by the caisses populaires in the main years studied by the commission. The loss statistics given here are based on a special questionnaire filled by 95 per cent of the caisses populaires holding 9[illegible] per cent of assets as at December 31, 1961:

Year	Number of losses	Amount of losses	Loans granted during the year
1940	65	$ 4,[illegible]50	
1945	6	2,[illegible]61	
[illegible]	[illegible]	[illegible]	[illegible]
1951	15	15,980	50,321,[illegible]
1952	18	9,0[illegible]4	55,480,[illegible]
1953	[illegible]	[illegible]	[illegible]
1954	24	1[illegible],736	70,[illegible]
1955	2[illegible]	[illegible]	97,115,[illegible]94
1956	[illegible]	[illegible]	[illegible]
1957	41	2[illegible]	117,3[illegible],[illegible]16
1958	[illegible]	[illegible]	[illegible]
1959	70	[illegible]	14[illegible],[illegible]67,057
1960	6[illegible]	25,3[illegible]7	12[illegible],[illegible]5,14[illegible]
1961	52	[illegible]	[illegible]

(1) Statistics from the Province of Quebec Bureau of Statistics based on the fiscal year and including all reporting caisses populaires in Quebec.

(2) Statistics based on the calendar year and including only the caisses populaires affiliated to the Quebec Federation.

c) Freedom of members of credit committee and supervisory committee

The members of the credit committee and of the supervisory board are not allowed to borrow or to endorse a loan. The purpose of this is to ensure the greatest freedom of action and to avoid the criticism that might be caused if they granted loans to themselves.

The manager and employees are not allowed to endorse loans.

Only the administrators who have no authority in the field of loans to shareholders may borrow and endorse loans.

d) Loans subject to approval by the regional union or the Federation

The credit committee alone has complete control of the loans to shareholders within the limits set by the general meeting.

However, a by-law in the regional unions requires affiliated caisses populaires to obtain prior approval from the regional union or the Federation to loan

1) over 5 per cent of the assets or $40,000 to the same shareholder;

2) to a public body;
to a business or industrial firm
to a co-operative society.

The purpose of this by-law is to avoid large loans to the same shareholder, something which could prevent the caisse populaire from granting many small loans; risks of loss through a lack of diversification are also to be avoided.

This by-law requires the caisse populaire to have the record of any corporation examined, and to seek the approval of a higher authority before granting a loan. Loans to enterprises and institutions require greater caution; it is necessary to ascertain the regularity of the incorporation, whether by letters patent issued under the Companies Act, or under various public acts. In addition, the corporation's legal power to borrow and its right to mortgage property provide other forms of security must be looked into.

The second stage consists of analyzing the financial statements and assessing the true financial position. Financial analysis requires a knowledge of accounting which the members of a local credit committee do not always have. The study will reveal the credit needs of the enterprise, the possible mode of repayment and the type of surety to be required.

The regional union or the Federation is then in a position to approve or reject the loan.

e) <u>Types of Surety</u>

1. <u>Acknowledgement of debt</u>

Loans granted against an acknowledgement of debt are made with or without an endorsement. Every caissé populaire sets its own policy in the matter.

Moveable assets are also accepted as collateral.

The purpose of this by-law is to avoid large loans to the same stockholder, something which could prevent the caisse populaire from granting many small loans; risks of loss through a lack of diversification are also to be avoided.

This by-law requires the caisse populaire to have the record of any corporation examined, and to seek the approval of a higher authority before granting a loan. Loans to enterprises and institutions require greater caution; it is necessary to ascertain the regularity of the incorporation, whether by letters patent issued under the Companies Act, or under various public acts. In addition, the corporation's legal power to borrow and its right to mortgage property or provide other forms of security must be looked into.

The second stage consists of analyzing the financial statements and assessing the true financial position. Financial analysis requires a knowledge of accounting which the members of a local credit committee do not always have. The study will reveal the credit needs of the enterprise, the possible mode of repayment and the type of surety to be required.

The regional union or the federation is then in a position to approve or reject the loan.

c) Types of Surety

1. Acknowledgment of debt

Loans granted against an acknowledgment of debt are [illegible]. Every caisse populaire sets its own policy in the matter.

The shares and savings of a member or of another party are also frequently used as collateral. The Act provides for automatic compensation at any time of the obligations contracted. (Section 46, paragraph 4 of the Act).

Other moveables which can be used as collateral include, first, such bond as are allowed under section 40 of the Act (those which may be owned by the caisse populaire) and, if authorized under the by-laws, other moveable assets, usually in the form of bonds. A security margin of 10 per cent is applied for easily marketable securities, and a larger margin is applied to other assets accepted as collateral.

The surrender value of life insurance policies, where the beneficiary is not the wife of the policy holder, is also acceptable.

In rural areas, farm products, livestock and farming implements may also be used as collateral.

Under a provincial act for the improvement of farms, the government provides a 10 per cent guarantee on loans up to an amount of $7,000 and refunds 3 per cent on the interest charges.

Maritime credit legislation assists fishermen in the financing of fishing gear and boats. The provincial government refunds 4 per cent of the interest to the fishermen and provides insurance on their life for the benefit of the caisse populaire. If the local caisse populaire is short of funds, it may obtain funds from the Caisse regionale de Gaspe and (or) from the Caisse centrale de Levis, to which the provincial

[illegible] are also frequently used as collateral. The Act provides for automatic [illegible] at any time of the obligations contracted (Section 40, paragraph 4 of the Act).

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government has provided a guarantee of $75,000 to cover possible losses.

Statistics of the Department of Fish and Game of the Province of Quebec - March 13, 1941 to Sept. 30, 1961

	Number of Loans	Amount Loaned	Interest Refunded	Loan insurance premium
Gaspe Area	2,128	$ 951,305	58,869	9,374
Madgalen Islands	2,757	$1,621,626	77,002	19,912
North Shore of Gulf	343	107,468	17,091	1,131
	5,228	$2,680,399	$152,962	$30,417

April 1, 1961 to October 1, 1961

	Gaspe Area	Magdalen Islands	North Shore of Gulf	Totals
Number of loans in force	196	322	133	651
Amount of loans in force	$384,908	414,536	37,535	836,979
Number of new loans	44	61	85	190
Amount of new loans	$50,114	52,150	21,200	123,464
Balance payable as of October 1	$271,740	295,279	22,907	589,927
Interest refunded by Department	$5,190	5,792	637	11,621
Insurance premium paid by the Department	$750	1,448	158	2,357

Credit is granted to settlers by the caisse populaires. The government of the Province of Quebec refunds 3 per cent of the interest to the caisse populaire and supervises the settlers' operations.

a) Loans to public bodies

The caisse populaire shares in the financing

government has provided a guarantee of $77,000 [illegible]

[illegible] loans.

Statistics of the Department of Fish and Game of the Province of Quebec - March 15, 1941 to Sept. 30, 1951

	Number of Loans	Amount Loaned	Interest Refunded	[illegible] Premium
Gaspe Area	2,183	$ 951,305	50,869	9,374
Magdalen Islands	[illegible]	[illegible]	[illegible]	[illegible]
North Shore of Gulf	390	109,468	17,081	1,130
	[illegible]	[illegible]	[illegible]	[illegible]

April 1, 1951 to October 1, 1951

	Gaspe Area	Magdalen Islands	North Shore of Gulf	Totals
Number of loans in force	[illegible]	[illegible]	[illegible]	[illegible]
Amount of insurance in force	[illegible]	[illegible]	[illegible]	[illegible]
Number of new loans	19	11	58	[illegible]
Amount of new loans	$50,318	[illegible]	11,130	[illegible]
Balance payable as of October 1	$271,140	205,129	48,557	539,927
Interest refunded by Department	5,190	5,742	657	11,621
Insurance premium paid by the Department	570	1,448	150	[illegible]

Credit is granted to settlers by the caisses populaires. The government of the Province of Quebec refunds 3 per cent of the interest to the caisses populaires and [illegible].

c) Loans to fishermen

The caisses populaires [illegible] in the [illegible]

of local public bodies - municipalities, school boards and "fabriques" - where the amount is not too large and the loan is for a short term. If it has the necessary funds available, the caisse populaire will gladly loan at reasonable terms. The rate of interest is usually lower than the current rate of interest against an acknowledgement of debt; it is in line with the usual rate on bond investments at the time the loan is granted. Such loans must be approved by the regional union or the Federation and by the Quebec Municipal Board. A loan to a "fabrique" must be approved by the diocesan bishop.

b) Loans to co-operatives

Loans are often granted by the caisses populaires against an acknowledgement of debt. The amounts vary according to the financial position of the borrowing co-operative. The rate of interest is usually the rate charged to other borrowers. Such loans are usually short-termed.

For medium or longer term loans, the caisse populaire requires the security of a mortgage or of moveable assets to protect itself adequately.

The caisses populaires have granted generous loans to housing co-operatives for their temporary financial needs in anticipation of loans to individuals by insurance companies or the Central Mortgage and Housing Corporation. We are informed by the Federation des Co-operatives d'Habitation du Quebec that 2,831 houses have been built since 1943 by affiliated housing co-operatives. It is believed that the actual

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number of new buildings constructed by the housing co-operatives for that period will be more than 5,000 units. It is known that a mortgage must wait 30 days after completion of the work to eliminate the risk of claims from workers and material suppliers and for architects fees, as such claims enjoy priority over the mortgage.

The caisses populaires loan to many housing co-operatives against the transferred security of the lending firm's promise of a loan. The lending firm is usually an insurance firm or the Central Mortgage and Housing Corporation.

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2 - Mortgages

This chapter deals with all loans secured by mortgages: leases with agreement of sale, sales with privilege of repurchase, etc.

Loans are generally granted on a first mortgage. Loans on mortgages are not restricted by law or regulations in relation to municipal assessment or other factors. Each application for a loan is judged on its merits by a credit committee. Loans, however, rarely exceed 65% of the market value of the property. Loans for low-cost housing, however, may reach 90% of the cost of construction.

The term of a loan varies with the capacity of each borrower to repay. In general, the term is 15 years, but the caisse populaire reserves the right to require repayment after 3 or 5 years. The borrower repays the loan in monthly instalments.

The caisses populaires use one form of mortgage deed which is standard throughout the Province of Quebec.

a) Family Dwellings

Under the Provincial Farm Act to improve housing conditions, which is administered by the Provincial Credit Bureau, loans are granted for one-family dwellings costing up to $12,500, including land. The maximum cost of two-family dwellings must not exceed $17,000. The maximum rate of interest permissible is 6¾%, and the provincial government reimburses 3% of the interest. As of 31st December, 1960, 743 caisses populaires had granted loans under this law, thus lending $86,244,569 to some 13,000 members.

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ii Family dwellings

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Rate of interest	Year	Number of loans under the terms of the Act	Number of loans granted by: Caisses populaires	Other enterprises
5%	1949	2,175	$ 2,884,877.24	$ 8,660,956.82
	1950	4,184	3,803,212.53	31,690,816.75
	1951	5,239	3,566,638.63	33,765,471.91
6%	1952	3,996	4,454,092.43	21,892,479.89
	1953	4,555	4,155,652.27	30,349,293.01
	1954	4,912	6,916,139.65	29,666,607.63
	1955	3,561	8,302,049.48	16,124,363.00
	1956	3,049	10,946,698.00	7,677,321.00
	1957	2,682	10,000,994.00	6,335,951.00
	1958	2,017	10,165,455.00	2,294,005.00
	1959	2,360	12,186,430.40	3,327,449.95
6¾%	1960	4,391 (1)	8,862,330.23	25,313,477.52
	1961	11,320 (2)	10,688,342.20	27,742,232.50
		54,441	$96,932,912.06	$244,840,425.98

(1) Loans granted prior to 1960 under the Act of March 1960 . Current loans	2,589		$ 21,290,630.00
(2) Loans granted prior to 1960 and accepted in 1961	1,802	$ 8,862,330.23	4,022,847.52
	7,969		$ 20,347,260.00

b) <u>Social value of loans on mortgages</u>

The caisses populaires may only grant loans for purposes which are productive and in the best interest of the borrower. Loans on mortgages are doubly profitable: 1. they enable the borrower to provide adequate housing for his family and 2. they help him to become a property owner. The family dwelling is a factor of social stability.

f) <u>Differences between regions</u>

There is little difference in the implementation of regulations in different regions, except for the limits imposed to each borrower by his assets and by the type of economy of the locality or region.

g) Rate of interest

1. Principles

There is usually a 1% difference between the rate of interest on loans against acknowledgment of debt and loans against mortgages.

A 1% reduction will usually be granted on loans granted against acknowledgment of debt when the loan is secured by shares, savings or bonds.

2. Loans against acknowledgment of debt

The chart below shows rates charged by the caisses populaires on loans against acknowledgment of debt. These rates were in force for affiliated caisses populaires at the end of the financial year 1961.

[illegible]	5	161,775
5.50% à 5.99%	6	491,707
6.00% à 6.49%	430	18,601,380
6.50% à 6.99%	100	6,181,095
7.00% à 7.49%	596	33,844,106
7.50% à 7.99%	37	6,819,204
8.00%	35	2,034,926
9.00%	1	132,245
	1,212	$ 68,267,840

Mode et médiane: 7.00%
Moyenne arithmétique: 6.63%
Moyenne pondérée par les prêts en cours au 31 déc. 1961: 6.75%

3- Prêts sur hypothèques

Taux d'intérêt	Nombre de caisses ayant ce taux d'intérêt	Prêts en cours au 31 déc. 1961
0.00%	101	
4.50% à 4.99%	1	$ 12,095
5.00% à 5.49%	128	14,427,277
5.50% à 5.99%	45	10,000,759
6.00% à 6.49%	610	124,397,393
6.50% à 6.99%	202	109,862,367
7.00% à 7.49%	124	60,262,442
8.00%	1	84,654
	1,212	$319,046,987

Mode et médiane: 6.00%
Moyenne arithmétique: 5.57%
Moyenne pondérée par les prêts en cours au 31 déc. 1961: 6.32%

Rates of interest on loans, as well as rates of interest on savings, do not vary widely nor do they vary immediately after changes in the financial market. As a co-operative, the caisses populaire is not a profit-seeking enterprise; it seeks to serve its members.

The rates of interest vary only gradually as they seek to get in line with the current rates.

Increasing the rates of interest in periods of tight money in order to reduce the volume of loans could well be unfair to members needing to borrow at that time. Why should any member pay 7% today when the rate was 6% yesterday? It could well be that such a member has entrusted his savings to a caisses populaire for the past 10, 20 or 30 years without ever needing to borrow; why should he then be penalized when he feels the need for a loan? If the caisse populaire does not, at the time, hold the liquid assets required, it refuses the loan. But if it has the funds required, even in periods of tight money, it simply cannot refuse to grant a loan at the current rate of interest when such a loan is justified by serious needs.

h) <u>Life Insurance on loans</u>

An individual life insurance policy on mortgage involves an automatic decrease in the amount of coverage. In the case of life insurance on loans, the amount of coverage is, at all times, equivalent to the amount due. Should a borrower die when he is late in his payments, his debt is entirely remitted; whereas in the case of individual insurance, the coverage in force may be less than the balance due at the time of death. Life insurance on loans affords the family an opportunity to own a fully paid home and to free itself of any obligation towards the caisse populaire.

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Presently, some 170,435 borrowers with loans from the caisses populaires are covered by such insurance. Since 1954, some 3,345 claims for amounts totalling more than six million dollars have been settled. Numerous testimonies show that the families concerned would have been deprived of their home had it not been for that insurance.

Life insurance on loans, on a group basis, is of considerable assistance to the working class, since otherwise this insurance would be prohibitive for workers not only because of the cost but also in view of the severe standards of medical examinations. Furthermore, on an individual basis, a considerable proportion of workers would have to pay occupational extra premiums to which professionals and white-collar workers are not subject. One must also bear in mind that workers are unable to build a home before they are well advanced in years, which tends to increase further the premiums of life insurance on mortgages.

Under such conditions, the type of life insurance on loans offered by the Caisses Populaires Desjardins is an essential service and constitutes for the caisse populaire a duty that it could not overlook without causing serious prejudice to the small wage-earner for whose sake it was instituted.

(See table on following page)

STATISTICS AS OF 31st DECEMBER, 1961

LIFE INSURANCE ON LOANS:

Premium (rate): 0.5½ monthly per $100.

Invalidity:

Premium (rate): 0.01 monthly per $100.

Dividend: 10% of premiums paid

Extra dividend: 10% based on experience

In force

Policies: 1,176

Amount: $346,488,264.

Recovery of premiums:

Individual charge: 625

Increase in rates of interest: 551

(Maximum coverage: $10,000)

IV. LIABILITIES

1. SAVINGS

a) Increase in savings in the caisses populaires

See monthly increase of savings from June 1957 to March 1962, in Section III, page

For previous data, see the situation of local caisses populaires, in statistical section, pp. 173-185.

Savings have been steadily increasing. It is the result of a long and costly programme of preparation and education.

As early as 1906, Commander Desjardins organized the first school bank in order to impress school children with the value of thrift and saving. The organization of school savings banks may have varied (in fact it has improved) but the purpose has remained the same: to train the younger generation to practice foresight, thrift and saving. The amount of savings collected through school banks is impressive, but even more so is the moral, social and economic education which they provide for the younger generation.

Some 335,762 school children in the Province of Quebec presently own $6,258,000 in savings. In Montreal alone, 130,585 children had $3,408,000 in savings in school banks as of December 31, 1961.

Such an educational enterprise calls for much effort, time and money but its beneficial results over the past few years, prove that it was well worth while.

The only French Canadian enterprises supporting an educational programme on the whole French television network of the CBC are l'Assurance-vie Desjardins and the Caisses Populaires Desjardins de Québec. The whole country benefits by these programmes which cost hundreds of thousands of dollars each year. The programmes do not carry commercials proper, but only a brief presentation at the beginning and the usual greetings at the end.

Savings may be withdrawn on demand. It is one of the reasons for the quite normal increase in savings over the past few years. Depositors who are not too interested in high returns may use their money as they wish and whenever they see fit. This seems to be of greater appeal to them than the higher returns on term deposits, though there are some who prefer the latter.

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Savings may be withdrawn over the counter or by means of a payment order (cheque) drawn on the caisses populaire. The use of payment orders in the caisses populaires goes back to the very beginning of the movement; it has been possible to trace some to the Caisse Populaire de Lévis, as early as 1907. The practice is not as recent as some people seem to think.

a) Distribution of savings accounts as of December 31, 1961

In order to study the distribution of savings accounts according to size, we have sent a questionnaire to 25% of affiliated caisses populaires representing a cross-section as to sector and assets.

Two hundred and fifty seven (257) caisses populaires, i.e. 20.8% of all affiliated, filled out the questionnaire. As of December 31, 1961, they totalled $150,345,710 deposited in savings, i.e. 22.2% of the total savings of affiliated caisses. These savings were distributed between 297,167 accounts.

Category	Total savings within this category			Number of accounts		
de $0.00 à $500	$ 19,424,134	ou	12.9%	223,162	ou	75.1%
$500 à $1,000	18,096,123	ou	12.0%	32,219	ou	10.9%
$1,000 à $5,000	77,947,807	ou	51.9%	37,950	ou	12.8%
$5,000 à $10,000	20,088,891	ou	13.4%	3,027	ou	1.0%
$10,000 à $25,000	9,672,648	ou	6.4%	688	ou	0.2%
$25,000 et plus	5,116,107	ou	3.4%	121	ou	0.04%
TOTAUX:	$150,345,710		100.0%	297,167		100.0%

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$1,000 à $5,000	77,947,807	ou	51.9%	37,950	ou	[illegible]
$5,000 à $10,000	20,088,631	ou	13.4%	3,027	ou	[illegible]
$10,000 à $25,000	9,672,648	ou	6.4%	588	ou	[illegible]
$25,000 et plus	5,116,107	ou	3.4%	127	ou	[illegible]
TOTAUX:	$150,346,710		100.0%	297,167		[illegible]

The above chart includes only ordinary savings against which payment orders may be drawn. To this should be added, in a special section, the $6,259,561 held by 335,762 depositors in school banks. Such savings accounts are obviously all below $500.

c) Use of savings accounts

In asking 25% of the affiliated caisses populaires to report on the distribution of their savings accounts, we also asked what proportion of those accounts were active and showed more than 12 withdrawals during the year 1961.

Two hundred and fifty-four (254) caisses have filled out the questionnaire thus revealing that out of a total of 279,975 accounts, 74,974, or 26.8%, had more than 12 withdrawals and that 205,000, or 73.2%, had less than 12 withdrawals. The following is an analytical chart of the caisses populaires showing the number of withdrawals in relation to their size:

	Plus que 12 retraits			Moins que 12 retraits		
	Nombre de comptes	%	Valeur moyenne au 31 déc/61	Nombre de comptes	%	Valeur moyenne au 31 déc/61
Caisses urbaines	46,530	29.2	$ 618.02	112,668	70.8	$ 537.37
Caisses semi-urbaines	10,465	26.0	750.24	29,716	74.0	398.28
Caisses rurales	17,979	22.3	681.22	62,617	77.7	362.91
Caisses ayant moins que $500,000 à l'épargne:	19,116	23.6	$ 594.67	62,023	76.4	$ 327.70
Caisses ayant $1,000,000 et plus à l'épargne:	36,504	27.0	667.44	98,826	73.0	565.98
TOTAUX:	74,974	26.8%	$ 641.93	205,001	73.2%	$ 464.92

d) Retraits sur l'épargne

Année	Valeur totale des retraits effectués sur épargne (1)
1950	$ 453,813,137
1955	854,265,083
1960	1,594,231,800

(1) Data based on the calendar year and including only the caisses populaires affiliated to the Quebec Federation.

e) Rate of interest on savings

The board of directors sets the rate of interest on savings. A co-operative principle requires that current rates be respected to prevent unfair competition. Since they do not have to contend with heavy operation costs, the caisses populaires may even occasionally pay a rate of interest which is slightly higher than that of the banks. Interest is always paid quarterly on the minimum balance.

Rates of interest on savings in affiliated caisses populaires, at the end of their financial year 1961, were as follows:

Rates of interest %	Number of caisses paying the stated rate	Savings as of December 31, 1961
0.00%	8	$ 190,242
1.00%	4	109,944
1.50% à 1.99%	35	1,308,661
2.00% à 2.49%	141	15,141,072
2.50% à 2.99%	373	113,487,646
3.00% à 3.49%	635	530,755,324
3.50% à 3.99%	11	16,222,496
4.00% à 4.49%	4	2,553,639
4.50% à 4.99%	1	3,704,128
	1,212	$ 683,473,152

Mode and median:
Arithmetic mean:
Average, weighted by savings as of December 31, 1961:

Most caises offering the benefits of life insurance on savings have two rates of interest. The first rate, usually inferior to the second by 0.50%, applies to the insured portion of savings; the second rate applies to savings not covered by the life insurance policy. In the above chart, only this higher rate was taken into account.

The rate is set according to the caisse populaire's ability to pay. In its early operations, the caisse has no reserves proper and obviously cannot pay the same rate as caisses which, having been in operation for several years, have considerable reserves. They start at 2% and the rate increases progressively with their financial potential. The members of the three boards or committees of the caisse are never remunerated for their services. In the first years of operation of a caisse populaire, the manager himself occasionally gets either no pay or only a very modest amount not at all related to the work accomplished.

Such dedication, together with the members' wish to manage their own enterprise, is an incentive to keep their savings within the parish in order to allow their capital to build up.

f) Effects of changes in the rate of interest on the volume of savings

Experience has shown that the rate of interest paid on savings is not a decisive factor in attracting deposits; no more indeed than a high rate of interest is an effective check against borrowing. The constant aim should be to pay the prevailing rate of interest.

[illegible]

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g) Life insurance on savings

Life insurance on savings is instrumental in encouraging and stabilizing at a reasonable level savings in the low income classes. Such an achievement is not without merit when one considers the low level of individual savings which, in spite of a considerable increase over the past few years, still stands at only $529 per member.

Life insurance on savings enable bread-winners to obtain additional low-cost security (very often it is their only life insurance policy) to enable them to cope with urgent needs. This protection, which would be prohibitive on an individual basis, is secured by diverting for that purpose, part of the interest normally paid on savings.

What would the worker do with a few more cents of interest on $500 of savings? It has been demonstrated that our members would rather see part of their interest transferred into a security of unquestionable value to their family. No less than 870,256 patrons of 1,176 caisses in Canada presently benefit from this type of life insurance on savings.

STATISTICS AS OF DECEMBER 31, 1961

LIFE INSURANCE ON SAVINGS

Premium (rate)	: 0.06½ monthly per $100
Dividend	: 15% of paid up premiums
Extra dividend	: 10% based on experience
In force:	
Contracts	: 863
Amount	: $240,003,253
Recovery of premiums:	
From the benefits	: 150
Reduction of rate of interest	: 622
(Maximum coverage	: $1,000)

Life insurance on savings is instrumental in encourag-ing and stabilizing at a reasonable level savings in the low income classes. Such an achievement is not without merit when one considers the low level of individual savings which, in spite of a considerable increase over the past few years, still stands at only [illegible] per person.

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LIFE INSURANCE ON SAVINGS

Premium (rate)	:	0.05¢ monthly per $100
Dividend	:	25% of paid up premiums
Extra dividend	:	10% based on experience
In force:		
Contracts	:	[illegible]
Amount	:	$240,[illegible]
Recovery of premiums		
From the benefits	:	1[illegible]
Reduction of rate of interest	:	6[illegible]
[illegible]	:	[illegible]

Increased protection:

In case of accidental death, the amount of insurance is doubled. Should such accident occur in a public building or in a vehicle used for public conveyance, the amount is trebled.

Family bonus:

In the event of the death of the father, the amount of insurance is increased by 10% per dependent child.

Accident benefits:

In the event of an accident resulting in the loss of limbs, savings are increased by 100% for the loss of two limbs and by 50% for the loss of one limb.

2 - CAPITAL

There is only one class of share: the $5.00 share, the value of which is fixed and may not be increased. According to regulations, a thirty (30) day notice must be served to the board of directors before a share may be withdrawn. A minimum admission fee of $0.10 per share is charged to the prospective member. It is paid directly into the reserve fund. In the caisses populaires with more extensive reserves and which can afford to pay a higher bonus on the share capital, the admission fee per share is proportionately increased; in some cases, it may reach $0.50 for each share in excess of 50. This admission fee is in fact a contribution to the reserve fund which the new member pays in order to make up for the sacrifices of the older members who have made possible the present reserves. Since the new member becomes co-owner of such reserves, it is only fair that he should thus contribute to their gorwth.

[illegible]

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[illegible]

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This admission fee is not refundable. It is a stabilizing factor of the share capital, and is, to a degree, one of the reasons why that capital is given a secondary importanceas compared to savings. Another cause is the maximum number of shares which may be owned by anyone as determined by the general assembly. This restriction is important in the early stages of the operations of a new caisse, as it prevents a few wealthy individuals from acquiring many shares which they could withdraw after a given time, if dissatisfied with the management, thus endangering the very existence of the caisse.

Membership shares are not transferable. It is practically impossible to purchase shares from another member; at any rate, this is not done since no profit can be derived from buying or selling shares. The member in need of cash may withdraw his shares; the caisse populaire will always pay $5.00 per share. Whoever wants to become a member or purchase more shares may deal directly with the caisse which he may legally join; he will never pay more than $5.00 per share, regardless of the size of the caisse or of how long it has been in operation. The board of directors may authorize the transfer of shares without exacting the payment of the admission fee for an heir in direct line of succession. In other cases, transfers are subject to the payment of further admission fees. This explains why there are no transfers except in settling estates.

a) Volume of withdrawals of membership shares

Year	Amount
1950	$1,355,099 [1]
1955	2,058,338 [1]
1960	3,433,325 [2]

(1) Bureau of Statistics for the Province of Quebec. These figures represent amount of refunds on shares surrendered during the fiscal year in all the caisses populaires affiliated to the Montreal Federation.

(2) Figures based on the calendar year and including only refunds on shares surrendered in the caisses populaires of the Quebec Federation.

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a) Volume of withdrawals of membership shares

Year	Amount
1950	$1,355,099 (1)
1955	2,058,358 (1)
1960	3,403,324 (2)

(1) Bureau of Statistics for the Province of Quebec. These figures represent amount of refunds on shares surrendered during the fiscal year by all the caisses populaires affiliated to the Montreal Federation.

(2) Figures based on the calendar year and including only refunds on shares surrendered in the caisses populaires of the Quebec Federation.

b) Rates of bonus

According to one of the principles of co-operatives, the interest on capital, generally known as bonus, is limited. Such bonus, while being slightly higher (by 1% approximately) than rates of interest on savings, varies between 3% and 5%. It is not therefore a case of distributing profits as in a joint stock company, the capital of which is made up of shares; it is a case of limited interest.

Rates of interest on bonus in the affiliated caisses populaires at the end of the financial year 1961, were as follows:

Taux de boni	Nombre de caisses populaires ayant ce taux	Capital social au 31 déc. 1961
0.00%	39	$ 59,228
1.00%	1	380
1.50%	1	617
2.00%	21	27,967
2.50%	3	7,069
3.00% à 3.49%	164	701,434
3.50% à 3.99%	13	212,688
4.00% à 4.49%	543	11,578,953
4.50% à 4.99%	38	3,584,730
5.00%	347	28,266,503
5.50%	4	2,509,368
6.00%	32	4,696,620
6.50%	1	16,229
7.00%	4	888,971
8.00%	1	30,738
	1,212	$ 52,581,495

Mode et médiane: 4.00%
Moyenne arithmétique: 4.06%
Moyenne pondérée par le capital social au 31 décembre 1961: 4.90%

c) Effects of bonus rates on the volume of share capital

The favourable effect of a high bonus rate in drawing more share capital is counterbalanced by the admission fee to be paid by the member. This prevents many members from acquiring further shares.

b) [illegible]

[illegible]
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Taux de boni	Nombre de caisses populaires ayant ce taux	Capital social au 31 déc. 1961
0.00%	39	$ 59,235
[illegible]	[illegible]	[illegible]
1.[illegible]%	1	[illegible]
2.00%	21	37,961
[illegible]	7	[illegible]
3.00% à 3.49%	164	701,424
3.50% à 3.99%	13	212,6[illegible]
4.00% à 4.49%	513	11,578,3[illegible]
4.50% à 4.99%	88	2,584,730
5.00%	347	28,205,505
5.50%	4	2,501,366
6.00%	32	4,[illegible]6,920
6.50%	1	16,229
7.00%	4	238,171
[illegible]	1	[illegible]
	1,212	$ 52,[illegible]1,151

[illegible]
[illegible]
Moyenne pondérée par le capital social au 31 décembre 1961: 4.40%

c) Effects of bonus rates on the volume of share capital

The favourable effect of a high bonus rate in drawing more share capital is counterbalanced by the admission fee to be paid by the member. [illegible] initial shares.

Example. - A $0.25 fee represents 5% interest on a $5.00 share over a one-year period. The member thus loses a full year of interest. In five years, he will get $1.25 bonus less the admission fee. This represents a net profit of $1.00 for a five-year period for one $5.00 share or a yield of only 4%.

In practice, the bonus rate has but little influence on the volume of capital. A liberal bonus rate may, however, have a stabilizing effect.

The share capital constitutes a joint ownership. Law links the share capital with the responsibilities of ownership; the share capital is thus subject to risks which do not affect the savings, which constitute one of the liabilities of the enterprise.

One may then readily understand that share capital is secondary to savings. In this connection, the caisses populaires may be compared to other financial enterprises receiving deposits.

d) Insurance against losses

The savings of the members are well protected by adequate reserves, efficient inspections, an all-inclusive policy for a minimum amount based on a general scale, an additional $10,000 bond applicable to all affiliated caisses populaires and finally by a substantial security fund in case all other safety measures should prove inadequate.

There is no need for insurance coverage against losses.

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There is no need for insurance coverage against losses.

V. RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

a) Bank of Canada

1. Selling agency

The Federation of the Caisses Populaires Desjardins is recognized by the Bank of Canada as an agency authorized to sell and issue Canada Savings Bonds.

An initial trust deposit of $20,000 was made by the Federation and was increased to $100,000 in 1958. The chart below shows the total sales for the various series of Canada Savings Bonds since 1946.

Emission	Vente ales
1e - 1946	$ 1,029,750
2e - 1947	496,850
3e - 1948	244,800
4e - 1949	292,050
5e - 1950	285,400
6e - 1951	453,900
7e - 1952	318,150
8e - 1953	1,798,450
9e - 1954	1,456,250
10e - 1955	1,979,450
11e - 1956	2,697,800
12e - 1957	3,996,250
13e - 1958	3,204,050
14e - 1959	7,965,250
15e - 1960	5,590,150
16e - 1961	6,803,850
TOTAL:	$ 38,612,400

2- Vente d'Obligations de la Victoire effectuée par notre entremise

Emission	Caisses régionales	Caisses locales	Sociétaires	Total
Ie emprunt	$ 279,500	$ 318,500	$	$ 598,000
2e "	465,000	577,000	597,700	1,639,950
3e "	515,000	1,108,050	983,550	2,606,600
4e "	1,220,000	1,907,750	1,670,800	4,798,550
5e "	960,000	2,261,800	2,842,200	6,064,000
6e "	850,000	2,727,800	3,800,800	7,378,600
7e "	435,000	2,671,650	5,024,900	8,131,550
8e "	525,000	2,172,500	5,881,900	8,579,400
9e "	580,000	3,619,950	9,800,050	14,000,000
GRAND TOTAL:	$5,329,500	$17,365,000	$30,601,900	$53,796,650

3- Emission du convertissement au 30 septembre 1958:

Emission	Caisses centrales	Caisses locales	Sociétaires	Courtier	TOTAL
5e emprunt	$ 492,300	$ 2,115,300	$ 79,400	$ 1,250	$ 2,688,250
6e "	751,450	2,404,900	135,600	1,000	3,292,950
7e "	2,043,550	2,147,850	192,550	6,600	4,390,550
8e "	127,700	2,418,050	272,250	6,000	2,824,000
9e "	352,400	3,192,400	424,250	10,250	3,979,750
TOTAL:	$3,767,400	$12,278,950	$1,104,050	$ 25,100	$17,175,500
Rajustement d'intérêt payé:	$ 58,167	$ 188,650	$ 14,699	$ 307	$ 261,824

The Federation of the Caisses Populaires Desjardins has been pleased to do its fair share in helping the Bank of Canada achieve one of its objectives.

b) An appraisal of competition

1. Rates of interest on savings

Rates of interest paid on savings and rates of bonus paid on share capital are basically the same as those paid by other financial institutions receiving deposits and granting loans.

The rate of interest on savings is determined on the same basis as in banks.

The slightly higher rates paid in some cases is accounted for by the lower costs of operation and by the fact that administrative functions are performed free of charge.

2. Rates of interest on loans

Loans are granted at prevailing rates, but frequently enough at slightly lesser rates since our main concern is to be of assistance to our members and not to make profits.

The Caisses Populaires grant their members the privilege of repaying a loan at any time without any penalty. Moreover, no interest is charged on any portion of a loan which

is repaid. Interest is never charged in advance. No commission is required from the borrowers. A manager, officer or employee who demands or accepts a commission or remuneration may be dismissed forthwith.

Such honest policies seem to meet with the approval of the members, as reflected by the growing membership of the caisses populaires.

The caisse populaire is satisfied with a profit margin sufficient to cover administrative expenses, allocate the necessary funds to the depreciation reserves, pay a reasonable rate of interest on savings and leave an adequate amount to pay on shares and make adequate appropriations to the funds proper of the caisse populaire.

3. Compulsory charges

Members normally pay the customary charges for cashing or exchanging cheques or payment orders.

There are service charges for accounting purposes unless the member waives interest on savings if his account is subject to a large number of deposits and withdrawals. Most caisses populaires, however, charge interest only on the balance due, without setting any minimum. Thus a $0.05 interest charge will be applied for an outstanding balance on a loan of $10.00 at 6% for one month. Other institutions feel justified in charging a $0.50, $0.75 or even $1.00 minimum.

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The following chart may be used as an illustration of the policies implemented by the caisses populaires:

$100 loans, at 7% interest, payable in 12 months:
11 monthly instalments of $8.34 and one final instalment of $8.26

	Balance due	Number of days	Rate of interest 7%
January	$ 100.00	31	$ 0.60
February	91.66	28	0.49
March	83.32	31	0.49
April	74.98	30	0.43
May	66.64	31	0.40
June	58.30	30	0.33
July	49.96	31	0.30
August	41.62	31	0.25
September	32.28	30	0.19
October	24.94	31	0.15
November	16.60	30	0.09
December	8.26	31	0.05
Amount of interest paid by the borrower:			$ 3.77

The public may judge the value of services rendered and then select the institution providing the most satisfactory service.

4. Services offered

The caisse populaire offers the following services to its members:

Savings: withdrawable shares
demand deposits
term deposits (few cases)
Christmas banks (budgeting for Christmas holidays)
school banks

Credit: small short-term loans
easy terms
reasonable rate of interest
against suitable security
larger medium-term loans
medium and long-term mortgage loans

Furthermore, some caisses populaires have safety deposit boxes for rent and a Canada Savings Bonds safe-keeping service.

Municipal taxes, telephone, electricity and gas bills may be paid at some caisses populaires. Moreover, rural caisses in the Province of Quebec collect dues on behalf of the Farm Credit Bureau.

5. Location of offices

Newly established caisses populaires are frequently set up in makeshift locations, such as a church basement, parish hall or a room in the manager's residence.

As soon as the caisse can afford to do so, it will move to a new and easily accessible location in the centre of the parish.

6. Offices

In the early stages, the offices are very modest. Later, especially when the caisse populaire owns a building, the office will have an attractive yet sober appearance.

Special attention is given to security and to the physical protection of values against armed robbery, burglary, fire, etc.

Armed guards are on duty in several caisses populaires.

Most caisses populaires have adequate alarm systems.

7. Business hours

The caisse populaire generally adopts the same business hours as other financial institutions and banks, especially when it has a full-time staff and is open during daytime. In the country, the hours will be different to suit the needs of the rural population. Most caisses populaires are open one or two evenings a week to accommodate workers who cannot call during normal hours.

8. Rate of expansion

In some quarters, the rather rapid growth of the caisses populaires has caused astonishment. This growth is readily understandable in view of the quality of services rendered to its members, in the field of savings and popular credit, by an institution which is jointly owned by them and managed by directors whom they have democratically elected. Each member may rightfully say "ma caisse". There is all the difference in the world between the services rendered to its members by a co-operative enterprise for the sake of providing assistance, and the same services rendered by a profit-making enterprise which, naturally, seeks above all to make maximum profits.

In the first case, each member is dynamically involved and plays an active part as an owner. In the second case, the customer has the impression of contributing to the enrichment of third parties: the shareholders. If the institution stands to gain from the operation, he will derive no benefit whatsoever although he has contributed in making the profit possible.

7. [illegible]

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In the first case, each member is effectively involved and plays an active part as an owner. In the second case, the customer has the impression of contributing to the enrichment of third parties, the shareholders. If the institution stands to gain from the operation, he will derive no benefit whatsoever although he has contributed in making the profit possible.

c) Influence of changes in the monetary situation

Changes in the monetary situation are barely noticeable. Should money be in abundant supply, the volume of loans will rise slowly and naturally. Conversely, when money is in short supply, loans will be restricted gradually, except in a case of major recession; in such a case not only will the caisse stop granting large loans, but it may stop granting loans altogether.

d) The exclusive field of endeavour of the caisses populaires

Any parishioner or resident of the community may become a member of the local savings and credit co-operative. The whole population may thus enjoy membership in the caisses. This does not preclude members engaged in industry, finance or trade from dealing with institutions which can provide financial services unavailable from the caisse populaire.

Relations with other financial institutions are cordial inasmuch as the usual rules of professional ethics are observed. The caisses populaires have never feared other monetary or financial institutions; on the contrary, they take pride in influencing other institutions to render similar services, on terms which are almost as attractive.

As the caisse populaire cannot cater to all the needs of its members, it welcomes the existence and success of other monetary or financial enterprises.

e) Clearing

Apart from ensuring the caisses populaires an attractive return on the liquid assets that they have to maintain and on the bonds that they hold in safe-keeping, the regional or central caisses have set up a complete and modern clearing service for all affiliated caisses populaires. They clear the cheques

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e) Clearing

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received by the caisses populaires and submit them to the banks for payment. On the other hand, the banks must be able to clear with the caisses populaires any payment order drawn against the latter. There is also the clearing of payment orders drawn on a caisse populaire and negotiated by another caisse populaire.

The ten (10) regional unions have therefore set up regional or central caisses populaires located in ten important centres of the province to negotiate on a day-to-day basis any such instruments drawn against a bank or caisse populaire.

The regional or central caisses populaires render obvious services to affiliated caisses populaires, but they also render a great service to the banks by submitting at one time all instruments to be cleared. Conversely, the caisses populaires of Montreal and Quebec daily redeem payment orders which are drawn on the caisses populaires and have been negotiated through a bank.

Cheques and payment orders drawn on a local bank or caisse populaire are cleared locally.

All such instruments are classified as to category and bank involved so as to reduce the workload of banks. On the other hand, the banks submit all payment orders in bulk to the Provincial Bank of Canada for immediate cash settlement. The orders are then debited to the central caisses populaires concerned, which look after their final distribution to the various caisses populaires.

The following chart shows the volume of instruments negotiated through the caisses populaires and the banks from May 1, 1959 to April 30, 1960.

[illegible]
Letters. There is also the clearing of payment orders drawn on a [illegible]

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The following chart shows the volume of instruments negotiated through the caisses populaires and the banks from [illegible]

Nom des institutions	1- Ordres de paiement présentés par		2- Chèques expédiés à	
	Nombre	Montant	Nombre	Montant
Les caisses populaires locales	2,371,828	$ 393,313,460		
La Banque Canadienne Nationale	2,638,061	316,274,477	1,716,698	$ 250,147,390
La Banque Provinciale du Canada	1,239,507	222,480,885	1,430,725	215,182,757
La Banque Royale du Canada	1,140,537	92,963,551	1,173,705	138,494,573
La Banque de Montréal	1,317,811	118,810,043	1,002,793	127,789,421
La Banque Toronto-Dominion	414,834	28,472,772	258,660	26,723,527
La Banque Canadienne de Commerce	586,283	49,474,857	332,197	42,538,922
La Banque de Nouvelle-Ecosse	230,202	21,458,491	157,389	15,312,854
La Banque Impériale du Canada	75,140	7,808,450	57,924	6,450,833
La Banque Mercantile	5,116	364,728	2,296	496,093
La Banque d'Epargne de la Cité et du district de Montréal	85,519	11,111,888	94,203	12,241,535
La Banque d'Economie de Québec	78,050	7,265,887	188,003	19,219,419
	1,296	155,612		
Totaux: transigé avec banques:	7,812,356	$ 876,641,641	6,464,598	$ 854,597,324
transigé avec caisses:	2,371,828	393,313,460		
GRANDS TOTAUX:	10,184,184	$1,269,955,101	6,464,593	$ 854,597,324

3- Chèques du gouvernement fédéral: (1)	Nombre	Montant
Allocations familiales	1,450,407	$ 30,609,032
Pensions de vieillesse	385,436	21,584,800
Autres chèques du gouvernement fédéral:	1,380,158	65,752,631
TOTAUX:	3,216,001	$ 117,946,463

(1) Numbers and amounts shown in section 3 are not included in section 2.

Regional or central caisses populaires are provided with the mechanical devices required for rapidly and efficiently discharging their duties as clearing-houses. They were the first to acquire bank proofing equipment. They also have equipment for micro-filming and endorsing and are fully equipped to ensure the efficient operation of this department.

SECTION III

THE CAISSES POPULAIRES and MONETARY POLICY

The Bank of Canada exercises no direct control over the caisses populaires. Some people see an injustice and a danger in this fact. It is argued that

a) the caisses populaires compete with banks and for that reason should be subject to the same restrictions and controls as the banks;

b) the caisses populaires and other financial institutions outside the banking system, not being subject to the same restrictions as the banks, make it difficult to effectively control the money

supply in the economy.

The first argument appears well founded. In fact, both banks and caisses populaires grant personal loans and mortgage loans. At first sight, it would seem that a substantial part of the over-payments realized by the caisses populaires on such operations are to be deducted from the profits that might be made by the banks if the caisses populaires did not exist. Such a claim, however, shows very little knowledge of the caisse populaire movement, because the savings directed to the caisses populaires are created, in a way, by the very existence of the caisses populaires, and particularly:

a) by the organization of a network of local caisses populaires designed to reach the small people directly, and covering over 400 municipalities or localities in the Province of Quebec, where no chartered bank has a branch office.

b) by an extremely active and efficient policy of popular training in thrift, through such institutions as the school banks, the young workers' banks, radio and television programs, etc.

c) by a loan policy directed to the needs of the economically weak, where the moral character of an individual is given more weight than his financial worth.

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c) by a loan policy directed to the needs of the economically weak, where the moral character of an individual is given more weight than his financial worth.

d) by a social philosophy and reputation for unselfish motives which is essential to create small savings.

Briefly, savings deposted in the caisses populaires by the common people are quite different from bank savings. The two types of savings cannot be compared directly, nor can one say that savings deposited in the caisses populaires are diverted from the banks. It would be fairer to say that the caisses populaires add to the total value of savings deposits and increase the total volume of loans inasmuch as such loans depend on the prior existence of savings. The creation of such popular savings is, indeed, the main contribution of the caisses populaires to the Canadian economy. The caisses populaires and the banks are not competitors.

It is true that, because they are not subject to the regulations, the caisses populaires undermind the effective control of the money supply? Let us look at the facts and see what are the conditions and limitations of monetary policy in Canada.

From a factual point of view, it is necessary to analyze the degree of sensitiveness of the credit policies of the caisses populaires to monetary restrictive policies. To say that the caisses populaires are not affected by banking regulations is to utter a half-truth, because while they are not directly governed by banking regulations, they cannot escape the policies of the Bank of Canada.

In the table on page , we have shown the

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In the table on page , we have shown the

monthly progression of savings in the affiliated caisses populaires and the net loans granted during the month for the period from June 1957 to March 1962.

In graph 1, page , we have shown the curve of monthly variations for loans and savings. It will be seen from this first graph that from September 1959, following changes in the Bank of Canada's monetary policy, the progression of savings fell dangerously, with a resulting drop in the volume of loans granted during the month. In November and December 1959 and in January and February 1960, the loans granted were even negative, i.e. repayments were greater than new loans.

In view of the vital importance of this graph, and in order to provide a better illustration, we have removed the seasonal variations through the use of a weighted variable average based on two superimposed three-month periods. The new curves are shown in Graph II, page . With the seasonal variations removed, it becomes even more obvious that the caisses populaires are strongly influenced by changes in the monetary policy of the Bank of Canada. Looking closely at Graph II, it is seen that from June 1959 to December 1959, the progression of savings was lower than net monthly loans and that the two curves dropped sharply, showing clearly that in a period of tight money, savings are affected in the caisses populaires as elsewhere, and that this will fatally have an impact on loans.

Perhaps there will be some surprise in finding that in the year 1959, the drop in net loans did not vary <u>immediately</u> with the progression of savings but was

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Perhaps there will be some surprise in finding that in the year 1959, the drop in net loans did not vary immediately with the progression of savings but only

delayed a month or two. This delay is partly explained by the loans approved by the credit committees of the caisses populaires prior to the money restrictions and concerning which the decision was known to the borrowers, thus constituting an obligation to loan. The delayed reaction may also be ascribed in some measure to the purely economic fact, quite apart from any policy of the caisses populaires, that consumer needs (personal loans) and housing needs (mortgage loans) are more stable in the economic cycle than industrial and commercial demand, and cannot as easily be restricted. In this regard, it may even be argued that if a system of popular credit were too sensitive to overall monetary policy, it would not take account of the relatively rigid nature of popular demand and would force such demand to suffer from the impact of a restrictive monetary policy, an obviously undesirable social result.

It is in order at this point to recall the opinion of the governor of the Bank of Canada in his annual report to the Minister of Finance for the year 1957: "It would, I think, be desirable that whenever the banks find it necessary to allocate their resources in the face of excessive total demand, they should limit the rationing process to the field of large loans, and should make it clear that this was the case." He went on to say: "The experience of the past 2 or 3 years suggests that much misunderstanding and difficulty would be avoided in future if it could be made clear that changing economical and financial conditions did not

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affect the banks' willingness and ability to accomodate credit-worthy small borrowers." The report clearly shows the existence of "misunderstanding and difficulty" resulting from credit restrictions on small loans.

Caisses populaires are always most sympathetic to the small borrower, but in periods of tight money, they are forced to curtail loans to protect their cash position. It is in trying to protect their cash position that the caisses populaires are indirectly influenced by the policy of the Bank of Canada, usually without even being aware of it. So long as the caisses populaires maintain their liquidity standards, they will be influenced by monetary policies.

In terms of controlling the money supply, there is little danger that a type of credit whose volume is related to the volume of popular savings could produce sudden and massive increases that might neutralize the effect of a reduction in bank credit. In that respect, Canadian monetary policy is much more vulnerable to international short-term capital movements. In the years 1958 - 1959, the finance companies, despite monetary restrictions, found an easy source of supply in speculative capital, mainly from American sources.

The same period showed that it is not easy to control the money supply in a country located near such a wealthy lender. A substantial part of the massive influx of American capital into Canada at the time was due, in fact, to the demand from provincial and municipal governments and from institutions that

strict the banks' willingness and ability to accommodate credit-worthy small borrowers. The study similarly shows the existence of "misunderstanding and difficulty" [illegible]

Chartered banks are, in principle, not unfavourable to the small borrower, but in periods of tight money, they are forced to curtail loans to protect their cash position. It is in trying to protect their cash position that the eligible borrowers are indirectly influenced by the policy of the Bank of Canada, usually without even being aware of it. So long as the [illegible] they will be influenced by monetary policies.

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could no longer find the funds they needed in the Canadian banking system. The alternative of borrowing in the United States, where relatively low rates of interest are favoured, renders the dream of absolute monetary control quite unrealistic. The idea is even dangerous when it results, as happened quite recently, in raising the value of the Canadian dollar in the midst of a recession. The fact that Canada is extremely dependent on outside markets places a serious limitation on restrictive monetary policies, as it does on the stimulation of consumer spending through tax reduction. All of which means that Canada is not the master of its real and monetary position. For Canada, a full-employment policy can be little else than a long-term policy consisting essentially in developing its foreign markets and promoting the best possible adjustment of its production structure in relation to the demand originating in the most active centres of international growth. Viewed in this light, an attempt to control popular credit through the Bank of Canada would, in its effects, be completely unrealistic.

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Netherent & Young
Toronto, Ontario

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PRETS NETS ET PROGRESSION DE L'EPARGNE DANS LES CAISSES POPULAIRES AFFILIEES

MOIS	ANNEES	PRETS NETS	PROGRESSION DE L'EPARGNE	MOYENNE MOBILE PONDEREE PRETS NETS	MOYENNE MOBILE PONDEREE PROGRESSION DE L'EPARGNE
7	1957	$ 1,967,117	$ 1,806,093		
8	1957	2,237,129	4,920,596		
9	1957	2,111,051	4,586,416	$ 2,095,718	$ 4,363,734
10	1957	2,387,355	4,431,031	1,872,927	4,229,625
11	1957	1,312,229	5,005,015	1,247,033	3,661,400
12	1957	610,590	670,074	611,666	3,373,175
1	1958	820,327CR	3,148,937	264,414	4,412,469
2	1958	302,070	7,609,418	685,937	5,949,945
3	1958	1,703,162	8,701,418	1,644,784	7,460,207
4	1958	2,890,971	6,350,469	2,783,192	7,974,686
5	1958	4,127,815	9,968,902	3,702,536	7,524,567
6	1958	4,411,796	7,770,717	4,142,680	6,558,167
7	1958	4,630,687	870,608	4,321,766	5,458,539
8	1958	3,640,765	7,681,869	4,219,105	5,486,909
9	1958	4,770,901	5,640,958	4,138,931	5,544,933
10	1958	3,834,684	5,542,725	3,748,345	4,985,637
11	1958	3,356,092	5,661,733	3,089,542	3,813,581
12	1958	2,336,305	2,044,685CR	2,322,001	3,187,663
1	1959	624,723	4,699,994	1,862,765	4,208,898
2	1959	2,092,783	8,556,850	2,253,140	5,603,095
3	1959	2,676,453	5,094,038	3,164,987	6,818,299
4	1959	5,061,259	7,213,930	4,456,388	7,291,331
5	1959	5,522,724	9,841,030	5,285,689	6,556,096
6	1959	6,432,582	5,553,206	5,592,469	5,459,435
7	1959	5,338,894	1,146,530CR	5,294,190	3,773,138
8	1959	4,249,986	7,872,373	4,638,873	3,044,385
9	1959	4,743,168	705,650	3,614,004	1,847,475
10	1959	2,403,200	889,093CR	2,093,031	234,735
11	1959	348,730CR	1,690,298	377,837	1,001,918CR
12	1959	1,411,181CR	7,884,375CR	964,383CR	940,056CR
1	1960	2,280,476CR	2,753,122	1,463,565CR	1,436,403
2	1960	1,590,692CR	7,194,874	1,112,105CR	3,750,757
3	1960	21,817	4,356,965	252,525CR	5,554,042
4	1960	691,628	5,836,398	683,854	5,709,446
5	1960	1,740,424	8,099,823	1,419,326	4,952,399
6	1960	2,146,020	1,767,371	1,832,002	4,100,838
7	1960	1,855,549	707,622	2,093,927	3,747,626
8	1960	2,166,387	8,154,144	2,276,386	5,132,174
9	1960	2,913,460	3,662,920	2,405,292	5,894,043
10	1960	2,304,281	11,218,682	2,294,669	5,618,963
11	1960	2,110,365	2,604,356	1,866,630	3,495,652
12	1960	1,525,142	3,774,073CR	1,288,443	2,732,340
1	1961	103,729CR	5,095,663	997,292	4,002,478
2	1961	703,012	9,294,562	1,452,810	6,344,233
3	1961	2,720,146	7,089,935	2,663,681	8,124,259
4	1961	4,208,281	8,617,194	4,127,197	8,902,188
5	1961	6,138,837	10,929,208	5,169,456	8,805,371
6	1961	6,098,956	8,935,168	5,536,812	7,738,145
7	1961	4,773,981	4,266,012	5,440,444	6,579,574
8	1961	5,500,528	3,830,175	5,298,621	6,842,023
9	1961	5,304,249	9,958,243	5,159,528	7,402,739
10	1961	4,930,595	12,704,004	4,891,574	6,710,167
11	1961	4,386,783	584,446CR	4,227,428	4,036,852
12	1961	3,349,791	298,277CR	3,312,926	3,185,358
1	1962	1,521,483	3,315,314	2,768,386	4,678,958
2	1962	2,019,838	11,397,314		
3	1962	4,724,989	10,551,060		

Royal Commission on Banking and Finance

Operation of the Monetary System in the U.S.A.
by
Woodlief Thomas

Hearings held at

Ottawa

Vol.	Date.
32	July 19, 1962

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F.J.Nethercut and R.J.Young
Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Thursday,
July 19th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
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Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
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Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Thursday, July 19, 1962.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

WOODLIEF THOMAS, ADVISER TO THE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D.C., U.S.A.

THE CHAIRMAN: I will now call the meeting to order.

This morning we have a submission from Mr. Woodlief Thomas, Adviser to the Board of Governors of the Federal Reserve System, Washington. We are very grateful, indeed, to you Mr. Thomas, for coming to Canada and for preparing a most illuminating brief. We have all read it with the greatest of interest and I am sure the members of the Commission, or most of them, have questions they would like to ask you and might discuss certain problems which may arise in the course of the questions.

It is a very great honour to have you present today in view of your distinguished career as an adviser to the Board of Governors of the Federal Reserve System. We welcome you most cordially and look forward to the discussion with the greatest of interest.

MR. THOMAS: Thank you, Mr. Chairman. It is a great honour for me to be here. I have always had great admiration for this country and particularly for its financial institutions and the people who are

Ottawa, Ontario,
Thursday, July 10, 196[illegible]

--- At [illegible] the hearing resumed.

[illegible]

WOODLIEF THOMAS, ADVISER TO THE
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON [illegible]

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MR. THOMAS: Thank you, Mr. Chairman. It is a great honour for me to be here. I have always had great admiration for this country and particularly for its financial institutions and the people who are

connected with them. I may say that in my brief and in any comments that I shall make I shall endeavour to present as nearly as possible what might be considered to be the views of the Federal Reserve Board or the Federal Reserve System, but as in any organization such as the Federal Reserve System where decisions are made by a great many people, it is not always possible to say what is the prevailing view. Also, the situation changes from time to time and policies and views which were adopted for one situation might need to be varied for reasons which are not always obvious, but I think the underlying principles will last.

There will be times when I will present what might be called a personal view which grows out of my own experience that may not necessarily represent the prevailing views of the Federal Reserve and I shall endeavour to indicate when those views are personal as much as possible.

Now, I have no further prepared statement than what I have submitted and I am open to questions. I have limited my submission mostly to the question of the operation of the central bank, the operation of the Federal Reserve System. I have not gone much into questions of banking supervision, bank regulations, chartering and various other questions on banking or questions of other banking institutions except in so far as they impinge upon the monetary system. But I am more or less familiar with those institutions and would be glad to endeavour to present any views that I can on other aspects if the Commissioners

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wish to have them.

THE CHAIRMAN: Thank you, Mr. Thomas.

COMMISSIONER LEMAN: Mr. Thomas, it is a privilege to me to have an opportunity to do what is colloquially called "pick your brains" a bit. I would like to ask you first a very broad question which arises from your comments particularly on pages 20 and 21 of your memorandum regarding the broad objectives of the monetary policy. You point out in paragraph 52 these broad objectives which you list as being four main ones -- sustained economic growth and development, reasonable price stability by avoiding inflation or deflation, protection of the value of the country's currency and at the same time maintaining the operation of free markets in a free enterprise system.

You point out these are broad economic objectives and not specifically only monetary policy objectives. You do point out, however, a little later in paragraph 54 that you wish to emphasize that these various goals need not be viewed as conflicting alternatives. It does seem to me, however, in reading your memorandum in other places that you do visualize that there might appear conflicts among these objectives. Would you say that in general these are only of a temporary nature or might they also be conflicting over a fairly long run?

MR. THOMAS: My view is that the conflicts are more apparent than real and of short term, that you have a long sustained growth in economy and develop-

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MR. THOMAS: My view is that the conflicts are more apparent than real and of short term, that you have a long sustained growth in economy and develop-

ment and you need reasonable stability of the price level in general and you need free markets and free movement of prices, of course. Those are things that cannot necessarily be assured by monetary policy. Any attempt to solve problems that are not monetary or financial in nature by money measures are more likely to result in difficulties than in solutions. I think many countries of the world today are suffering from attempts to correct situations through monetary means or fiscal means that are really of a structural nature caused by difficulties in obtaining adequate productivity and adjusting prices of individual products and services to bring out the best demand from the public and attempts to solve them by creating additional liquidity have not had as much success as it was supposed to have.

I have an idea that many countries with balances of payment difficulties -- and I would include the United States in that -- have found that they cannot solve their own problems by just creating money. You get to a point where the creation of additional money means that the money will go out of the country to other places and problems have to be solved by other sorts of adjustments. I do not think there is necessarily a conflict between, say, full employment and stopping inflation, for example, as some people like to say.

THE CHAIRMAN: Mr. Thomas, the acoustics in this room are not too good, and if you would not mind raising your voice a little bit --

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MR. THOMAS: I will do the best I can.

THE CHAIRMAN: We can hear very well but there are a number of people in the audience in addition to the Commission who are very interested in what you have to say.

MR. THOMAS: As I told you once, my wife's definition of economists is a bunch of gloomy guys who get together and mumble. We have that proclivity.

COMMISSIONER LEMAN: I wonder if we could close in a little bit on this business of possible conflicts. The first one you mention is sustained growth and development. Would you say that one could ascribe some priorities to these objectives?

MR. THOMAS: I view the monetary policy as really having somewhat limited specific goals. The task of monetary policy when it gets down to it, the central bank or monetary system, is to assure that the economy has enough money to serve the purposes of these broad goals and that is only one of the essentials for attaining these goals and it is a relatively narrow one, and money has to be defined fairly narrowly. It is the cash balances that people want to hold in banks or in currency. That is what it really gets down to and the task of monetary policy, of the central bank operation, is to try to figure out what is the appropriate amount of money that is needed at any one time.

Now, it is not an easy task. It is a task that involves very difficult judgments and it involves

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a great deal of information and the amounts vary from time to time for different reasons. But most of the people who criticize monetary policy either expect it to do a great deal more than it should be expected to do, or want it to do a great deal more than it can be relied upon to do, and there are dangers in attempting to accomplish through monetary policy more than it can perform.

You can create money for particular purposes and extend credit for particular purposes, but the real long run effect of that is not going to be the immediate purpose for which the money was originally used; it is going to be the uses that are made of the money after it gets into people's hands and if people get more cash than they want to hold, they are going to spend it for a variety of purposes over which the monetary authorities have no control. If they have less than they want to hold, they are going to start saving and hold back on spending. Under those conditions money is needed. So that I think we have to view the task of the central bank in this limited field and not in as broad a field as many people do. I am not saying that it cannot have very broad effect. It can have quite large effect but the question is whether it should have and whether those effects can be controlled once they start expressing themselves.

COMMISSIONER LEMAN: Would you be inclined to give these factors perhaps more of a negative value than a constructive value? For instance, monetary policy in the area of holding the economy in a state of

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COMMISSIONER LEMAN: Would you be inclined to give these factors perhaps more of a negative value

sustained growth and development, could monetary policies do much in that field or is it more effective in the field of the other objectives you have mentioned such as prevention of inflation?

MR. THOMAS: Well, to have sustained growth and development it is absolutely essential that there be an appropriate amount of money. The question of what is the appropriate amount of money is a question of judgment. That is why we have an elaborate process of decision-making by the monetary authorities. That is a decision they are faced with every day because we in Federal Reserve engage in hundreds of millions of dollars of operations every day, sometimes buying $1 billion of government bonds within a week or a day, or add to our holdings by that amount, or maybe buy and sell more. Those are day to day operations to take care of the fluctuating money needs of the economy. They are not necessarily broad policy objectives, I mean not necessarily designed to accomplish the broad policy objectives except that they make it possible to have day to day short term movements in the money market without interfering with the broad policy objectives.

COMMISSIONER LEMAN: I wonder if any of the other Commissioners want to argue about this point any further.

COMMISSIONER MACKINTOSH: Would you say, Mr. Thomas -- if I can just interject one question in relation to the growth -- the appropriate amount of money is that which anticipated the growth or simply adjusted itself to the growth that has taken place?

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MR.THOMAS: I think you have to do a little of both. The adjustment can be very quick in a properly functioning monetary system but it has to be somewhat anticipatory. In the Federal Reserve we have always endeavoured to avoid adopting any single formula as to a rate of growth in money because we have found that the amount of money the public needs or wants varies quite a lot from time to time under changing conditions. It is affected by attitudes, expectations, the general state of the economy and sometimes you need more, sometimes you need less, relative to the volume of economic activity as it is going on, or the rate of growth that might be desired.

COMMISSIONER LEMAN: You told us, Mr. Thomas, that one of the problems stemmed from the fact that people expect monetary policy to achieve too much towards these objectives and therefore those authorities who are in charge of operating and formulating monetary policy have to convince themselves from time to time that there are conditions in the country which hamper their ability to achieve the objectives through what they can do. Is it therefore their duty at that time to point this out and explain what in their view, are the conditions which are basic and prevent the possibility of using monetary policy in a useful way?

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That is a very difficult situation for the central bank to be in. At times he has to do it, of course, for alibi purposes, if for no other reason, in order to explain why he cannot do the job that is expected of him. He has to indicate what he considers to be the real causes of failure of the economy to perform as it should. To a certain extent that, of course, has to be done, and sometimes it can cause troubles.

COMMISSIONER BROWN: I wonder if I might ask a question here, Mr. Thomas? We all talk about inflation and deflation and the desire to avoid these. I think we all feel we know when we have inflation and when we have deflation, but is there any empirical measure as to what constitutes inflation in your opinion, or what is acceptable inflationary pressure or deflationary pressure?

MR. THOMAS: It is not as simple as words would imply. Basically and fundamentally, of course, inflation is reflected in a persistent increase in prices of commodities, but there are situations where one might have what is really from the standpoint of its effect in inflationary development which may not be reflected in increasing prices. Let us take, for example, the situation where there is a great increase in productivity in the economy, and the effects of productivity are not reflected in a decrease in prices. The benefits are not passed along to the consumer in purchases but are held back either in profits or wasteful expenditures, or maybe in higher

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wages to a particular group. That sort of situation can have a lot of the element of inflation. I think we had something like that in the late 1920's. Prices were not rising, at least commodity prices were not rising but we had an increase in corporate profits and a tremendous stock market speculation based on credit, which was not, by ordinary definitions of inflation, an inflationary situation, but it had a lot of the characteristics of inflation and ended in a complete collapse which lasted an awful long time because of the unsound credit structures that were built up during that period on the basis of anticipations that could not be realized.

Generally speaking the measure of inflation is a rise in prices of goods and services.

COMMISSIONER GIBSON: There is a very widely held view that we are living in a world where there is more of a bias toward inflation than there used to be because of changes in the society. Most western countries have as their prime objective placed more emphasis on full employment and growth, and in this kind of a world inflation is the more likely phenomenon than it was, let us say, in at least part of the 19th century. You said earlier that there were many examples of countries that were trying to make monetary policy do too much to offset situations which were not really amenable to correction by monetary measures. The question I should like to ask is, do you agree with this view? First, perhaps you should comment in regard to how much of an inflationary environment we

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should have, and if this is a sensible view, how can monetary managers avoid finding themselves in the position where they are frequently attempting to offset developments and pressures in other directions which they may not be able to fully or effectively offset, but they still feel they ought to do what they can do to cope with it?

MR. THOMAS: This is a personal view and not the view of the Federal Reserve.

My view is more like that of a very optimistic nation, that the world is not faced with a fundamental inflationary situation. We have destroyed the productivity of the world which was produced by the war, and which filled a great many shortages.

The world in general is in a situation where costs can be lowered and are being lowered, and it may not even be possible to create inflation in this situation. No one country can create inflation or even provide its own nation with a stimulus if its cost structure and price structure is out of line with the rest of the world. No one country today can determine its own interest rate level. We have had a situation in the past two years where, in the United States, we have had to refrain from letting interest rates fall. You notice that I said, "letting interest rates fall". We do not put them down, we refrain from letting them decline. This might be appropriate. The Germans have actually found it necessary to either lower their rates or let them decline when they would like to maintain a better money policy because of the

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Now, it follows from that view also that we may not need restrictive policies. It does not mean we have to have a restrictive monetary policy. It means that a restrictive monetary policy may no longer be as necessary as it was during the post-war period when the world was building up its capacity and we required a large volume of savings to build up that capacity. So I think we are in the situation, in a sense, of better balance, but in one which will be much more difficult to maintain through governmental action.

COMMISSIONER GIBSON: Well, to narrow the question down to a smaller field, what alternatives do central banks have in countries where there are inflationary pressures or policies being carried out

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than to attack to some extent, these pressures to offset them? Is this a good approach? You said there are lots of examples of central banks trying to cope with situations which are not really correctable or amenable to monetary policy. Can they do much less under the circumstances? If you have these pressures in the economy, what do they do?

MR. THOMAS: Some of them have done other things. Italy and Germany, and today France; those countries in the end come out better than those which have endeavoured to solve the problems by monetary creation or budget deficits.

COMMISSIONER GIBSON: Or monetary restrictions?

MR. THOMAS: Yes, or monetary restrictions. Italy and Germany maintained monetary restrictions during the period of expansion and they are able now to relax somewhat. Whereas, some other countries which did not maintain restrictions keep finding themselves in difficulties with balance of payments problems and so on.

I do not know that it is a question of alternatives any more. It is reflected very quickly in the value of the currency and in the balance of payments, and you are soon faced with a question of fundamental adjustment trying to solve problems by re-valuation downward or upward in some cases of the currecny, because the adjustments were not made in the individual situations as they should have been.

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COMMISSIONER GIBSON: What you are saying is that if you have got a particular problem, being out

of adjustment with the rest of the world in your own economy which creates an excessive demand on your resources you must have a broad attack on that problem, not just a monetary attack. Supposing a broad attack is not made in respect of the whole problem, what do the monetary authorities do in these circumstances? Is a restrictive policy proper if there is not a fiscal policy that goes along with it?

MR. THOMAS: Well, I get back to what I said earlier, that the task of the monetary authority in any of these circumstances is to try to figure out what is the appropriate volume of money to maintain the economy with the resources it has, but not try to vary it when you find that money is leaving the country either because the interest rates are too low or because prices are too high relative to those abroad. This is a pretty definite sign that the monetary means are not the answer, particularly in a situation such as we have in the United States where we have a slackening economy. We would like to stimulate it. I think our administrators recognize pretty clearly that there are limits as to how much stimulation you can give to the economy without suffering from a balance of payments problem.

COMMISSIONER LEMAN: Are the symptoms quite recognizable when the problems that have to be solved are basic, but are not amenable to monetary policy solutions? Does it become quite clear? Can someone stand up and prove to the people where the problem is?

MR. THOMAS: No, and of course that is the difficulty. You can never get any group of economists in a room together to agree on what really are the causes of a situation, and we have that same problem with government officials. It is a far more complicated problem than just building statistical models and saying: This is what we would like to have. The question is, how can those things be attained and it is not, to answer Mr. Gibson a little more fully, all just a matter of what you can do about it. Sometimes you just do not do anything about it and you have to leave it to the market forces to work this out and suffer the consequences. I think in the end the consequences may be much less than if you attempt to solve them by governmental measures which interfere with the operation of the adjustments which are essential.

COMMISSIONER LEMAN: You said a minute ago that one of the basic problems was to keep in the economy the proper amount of money needed for the smooth functioning of that economy. Is it not possible to say that this very narrow objective of maintaining the proper amount of money in the economy has been set aside?

MR. THOMAS: Well, we have lots of figures and we use them and analyze the past and project them so as to determine policies for the present and future. We do endeavour to show by the figures what has been accomplished and what might be accomplished, but different people can get different things out of

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figures.

COMMISSIONER LEMAN: Can you tell us perhaps what are the sort of questions that monetary authorities would ask themselves in trying to arrive at this answer?

MR. THOMAS: Well, let us take a meeting of our Federal Open Marketing Committee, which I think is one of the most impressive examples of the processes of decision making that at least I have ever been able to experience or see. This group meets once every three weeks, approximately. There are seven members on the board; there are five Reserve Bank presidents who are members of the Committee, and the meetings are generally or nearly always attended by all the other Reserve Bank presidents. There are 19 people sitting around the table discussing the situation. Before they come to that meeting they have had memoranda prepared by the board staff in respect of the economic situation and current developments. They have had reports from the manager of the Federal Open Marketing Account in New York which operates the government security market, in order to see what is going on there. In fact, they have had daily reports as to what goes on in that market and what has been done about it.

Each Reserve bank president before he comes there meets with his own staff and discusses the situation and they reach the point of view as to what may be going on, and the Committee meets and it has a report from its manager as to the market situation. Two economists of the Committee -- and I was an economist to the Committee, I was one of them -- one will present about a ten minute analysis of the principles of our business development and economic factors, and these are not simply just factual, they are analytical and may end with a point of view and even at times a recommendation for policy, and the other will present an analysis of the financial developments. Now, those are quite independent; the chairman or no member of the Board tells us what to say in our own presentation. It is supposed to be an objective economic analysis.

Then, each member of the Committee, each person there, each member of the Board and each Reserve bank president then presents his statement, and they sometimes talk about the conditions in the different federal reserve districts, but generally they impart any important developments in their districts and end up with a statement of a view as to what they think the situation calls for and what the monetary policy is.

In the evidence the Chairman of the Board attempts to represent his view or gives what he thinks is the concensus that may develop in the presentation.

If there is any disagreement with that concensus, the individual members of the Committee may express it. In this process frequently one will find

Each Reserve bank president before he comes there meets with his own staff and discusses the situation and they [illegible] the point of view as to what may be going on, and the Committee meets and it has a report from its manager as to the market situation. Two economists of the Committee -- and I was an economist to the Committee, I was one of them -- one will present about a ten minute analysis of the principles of our business development and economic factors, and these are not simply just factual, they are analytical and may end with a point of view and even at times a recommendation for policy, and the other will present an analysis of the financial developments. Now, those are quite independent; the chairman or no member of the Board tells us what to say in our own presentation. It is supposed to be an objective economic analysis.

Then, each member of the Committee, each person there, each member of the Board and each Reserve bank president then presents his statement, and they [illegible] in the different Federal reserve districts, but generally they impart any important developments in their districts and end up with a statement of a view as to what they think the situation calls for and what the monetary policy is.

In the evidence the Chairman of the Board attempts to represent his view or gives what he thinks is the consensus that may develop in the presentation.

If there is any disagreement with that consensus, the individual members of the Committee may express it. In this process frequently one will find

a change in view developing as you go around the table, but more often -- because most of their statements have been prepared before they get there -- the change may come three weeks later, but if there is clear evidence of an urgent situation a viewpoint can be changed quite quickly in that process.

Now, as a result one comes out with a concensus and even where there are differences of view, there is better understanding all around of the different areas of view that have been expressed. Individual members may present different points of view.

The result of all this becomes public knowledge at the end of the year; the Board has to publish a record of policy actions by the Open Market Committee and give the reasons for decisions reached, and any member who votes against the decision that was reached is entitled to and is expected to give the reasons why he voted otherwise. Now, those public records are the net result of the deliberations; in this process of going around and each member talking, a concensus is generally reached rather quickly.

COMMISSIONER LEMAN: I think you described for us how difficult it is to arrive at the answer and what processes people use to try and get some kind of unanimity, et cetera, but the point of my question was rather this; in trying to arrive at this answer of how much money you need in the economy under certain circumstances, do you have to look at thousands of factors or are there, say, three or four very important basic factors to look at to try to arrive at

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a conclusion?

MR. THOMAS: Well, I was leading up really to answer your question, what are the factors that are of concern to those people in reaching these decisions. They view what is going on in production and employment, in the various aspects of production and employment, and also sales and inventories and any information that may be available, the whole of the investments, all the usual business statistics that are available and also some information which we get that is not statistical. I mean the contacts of the Reserve bank presidents, Reserve bank people, the business man in that community, they pick up a lot of straws in the wind which may or may not be indicative, but they are thrown into the picture and when they get down to an ultimate decision as to what should be done, the decision is based upon what amount of reserves they need to be supplied to the banking system in order to meet what is considered to be the necessary monetary requirements, so we do have the measures of the money supply and we have measures of what the money supply has been in the past with protection and as to what we think is an appropriate level under the circumstances that are prevailing and which are converted here into what would be the volume of reserves that are needed to support that level, given the usual seasonal variations, or variations that may be due to some temporary factors such as a treasury financing operation, or something of that sort, and the Committee has before it some rather specific statistics on what

might be proper in the near future.

Now, these projections do not always turn out to conform to what actually happens; they are not presented as forecasts, they are presented as a sort of guide or goal towards which the Committee might operate in this short period of time.

Sometimes we present them for longer periods, but just as a rough indication of where we think the economy ought to be going in order to reach the goals that are desirable.

We have great masses of figures; we have an analysis of the flows of funds throughout the economy; how much is borrowed by different sectors in the economy and how much is lent by different sectors, and there is planning as to where the money is going to and coming from, and they even project all these details into the future from time to time.

COMMISSIONER LEMAN: Might we say, Mr. Thomas, that therefore it is not a question necessarily only of the amount of money in the economy -- as you define "money" -- but also the question of how this stack of money is used at the time and is being used by the people?

MR. THOMAS: That is right; how it is being used or is likely to be used is taken into consideration, though, as one of the indicators of how much you need to provide.

There are conditions when you need to provide more because the money is not being used relative to the level of economic activity, and there are other times

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There are conditions when you need to provide more because the money is not being used relative to the level of economic activity, and there are other times

when you need to provide less, and also it gets back to how the money is provided.

Under our system -- as we bring out in the submission -- the Federal Reserve control over the amount of money is not precise or exact because of the possibility that there are thousands of banks -- some banks may have reserves and not use them, they may have excess reserves and hold them as excess because they choose not to use them; other banks may be short of reserves and will choose to borrow reserves from the Federal Reserve.

Now, that creates additional money which makes it unnecessary for the system to supply reserves through open market operations. On the other hand, when banks borrow they are under restraint, so that at times the result of borrowing would be to exert a strain on expansion, and that restraint might be desirable under some conditions and it might not be desirable, so the system has to make up its mind whether you are going to relieve banks of the need to borrow in order to obtain reserves that they want, or whether you are going to make it necessary for them to continue to borrow and even to borrow more -- if they want more -- than seems to be appropriate at the time. So, these again are some of the questions of judgment, but we do give them rather specific figures that they can use as guides, rough guides to what they should do in any particular week or day.

Every morning at eleven o'clock the manager of the open market account in New York calls somebody

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at the Board -- I used to take that call -- and they report on what the situation is in the money market, in the government securities market, and they have projected four weeks in advance by days what we consider the amount of reserves in the amount of open market operations will be necessary to maintain a given volume of reserves for that period, and they change every day because different factors come in but they are quite definite measures that we use as guides from day to day and week to week and month to month and year to year.

COMMISSIONER LEMAN: So now we have three factors; it is the amount of money, who holds the money and, stemming from who holds it, how is it being used? You have three variables here that make this process possible.

MR. THOMAS: Yes, but from the standpoint of the bank the thing that we can control is the amount of money, and you have to take into consideration the variations and these other factors in deciding what is an appropriate amount of money under the circumstances.

Take the year 1959; it is a very important example in history of monetary theory, I think. In the year 1959 we had a booming economy and a definite limit as to how far the economy could expand, because we had a steel strike which limited the capacity to expand. We also had a tremendous private demand for credit, a record-breaking private demand for credit, and tremendous budget deficits -- probably the biggest

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budget deficits we had ever had in a peacetime year -- coming along with a strong private demand for credit and a booming economy.

Now, these credit demands were met. $60 billion was the total credit demands in that period and they were met, but they were met with practically no expansion in the money supply, with very little expansion in bank credit -- and that was met by time and savings deposit expansion; the money came out of the savings of the public. Now, it took some fairly high interest rates to draw it out, but it came.

I think this example shows that one can finance a budget dividend with a high level of private activity if you follow the appropriate monetary policy, and that the existing rates function.

Now, they did the job and we maintained as high a level of activity as could be maintained in that year without an expansion of bank credit and inflationary consequences.

Now, the years 1960 and 1961 presented a different situation; for various reasons there was a slackening in the economy and money was freely available and credit reserves were available, banking credit expanded but the private demands for credit were less -- at least in 1960 -- and interest rates went down; the money was there and was made freely available.

COMMISSIONER GIBSON: I would like to ask you a couple of questions on the limits and scope of monetary action. On pages 32 and 33 there is quite

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COMMISSIONER GIBSON: I would like to ask you a couple of questions on the limits and scope of monetary action. On pages 32 and 33 there is quite

a long quotation from the report of the Board of Governors to the Commission on Money and Credit, and at the end of the first paragraph on page 33 you make the statement that, at least, the submission to the Commission makes the statement:

> "At times structural imbalances develop that cannot be corrected by general public policies."

I presume they mean any general public policies. Would you care to talk about this structural imbalance and the sort of thing which really is right in the range of monetary policy?

MR. THOMAS: Well, I think the striking example, of course, in the present situation is the question of what is a proper wage level. We have had a situation for years where wages have steadily increased in certain areas and which have probably created some distortion in our income distribution and have prevented price adjustments that were essential to maintain the demand for certain products.

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Another example would be what the automobile industry did in 1957-1958 when the Americans had automobiles which they did not want and they suffered the consequences. The plan in the reduction of automobiles and the unemployment that developed in Detroit at that time could not have been solved by stimulating housing in Detroit, for example. They had houses available; home building.

The other examples are in the international field, that Western Europe has a definitely lower wage level than our level. It was not too important in the world markets until the Europeans had built up their productivity -- their output -- up to the point where they were meeting their domestic demands and were able to enter export markets. When they became able to enter export markets they became definitely strong competitors, and whereas we had had rather a monopoly of supplying certain types of goods to the world we found ourselves facing competition.

I don't think those problems can be solved by monetary policy. Questions of agriculture development: We have had a tremendous increase in productivity in agriculture. That has not been reflected altogether in the prices of agriculture products because they have been supported, and the result is we are building up surpluses; we are producing goods that nobody will buy at the prices that are being asked. That cannot be solved by monetary policy.

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COMMISSIONER GIBSON: We seem to have quite a few structural problems in North America at this

time?

MR. THOMAS: I don't think it is limited to North America. I was in Chile two weeks ago and they have a very high cost structure. I think I would say that some of the British problems are of a similar nature -- problems in the United Kingdom.

COMMISSIONER MACKINTOSH: Would you care to add any Canadian problems?

MR. THOMAS: I will let you speak for that.

COMMISSIONER LEMAN: This business of economic growth and development -- that is not a simple objective, is it?

MR. THOMAS: It certainly is not.

COMMISSIONER LEMAN: Growth can be quite uneven in the economy?

MR. THOMAS: Growth can be uneven and it involves constant adjustments in the structure of the economy, and those adjustments have to take place. New products develop to take the place of old ones, and the market has to make those adjustments and try to maintain a decadent industry It does not necessarily solve the basic problems. It does not give you growth. It does not give you maximum sustainable growth.

COMMISSIONER GIBSON: You take all these structural problems into account in your thinking in determining monetary policy, though you don't aim policies to suit the fact; is that a fair statement?

MR. THOMAS: Yes, I think that is a fair statement, but I think in general the guides of monetary policy -- meaning by "monetary policy" the

amount of bank reserves that are supplied -- can in a brief period be somewhat more exact. All you need to do is just to say that you cannot expect to stimulate the economy when these other conditions exist, but in general the excesses are likely to be reflected in one of your indicators or another. Of course, the balance of payment situation is a clear-cut one: When funds start moving out of the country, or you get an unfavourable balance of trade, it is an indication that there is something wrong somewhere. You can do what you can by interest rate adjustments, but if you are in the situation where you want low interest rates and are losing funds, or low interest rates for domestic purposes, and money is going out, it seems to me to be a clear indication there is something structurally wrong in the economy. The money stimulus is not working.

COMMISSIONER GIBSON: Is it possible that the low interest rates might not be appropriate in those circumstances?

MR. THOMAS: There are too many negatives in that statement.

COMMISSIONER GIBSON: In these circumstances might it be possible that the policy of maintaining low interest rates was not altogether appropriate? I guess that is a banker's statement too.

MR. THOMAS: Yes, that is right. Chairman Martin in Congress two days ago said there is a limit how far we can go in pushing interest rates as a solution for certain problems. The point is reached

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where money just lies there and is not used, or it may be used for purposes that are not for the best interests of the economy.

COMMISSIONER GIBSON: Would you care to say anything about how you think some of these major structural problems should be tackled? I realize it is outside the sphere which you have allotted yourself.

MR. THOMAS: Yes, it is outside. I don't know that I have the answer. I would be inclined more to rely upon market forces to adjust it. All I can say on this subject is, just don't think you can solve them by monetary and physical measures. If you attempt to you are likely to fail and may even create more difficult situations.

COMMISSIONER GIBSON: You have referred on more than one occasion to the policies adopted by Germany and France and Italy: Is that the kind of direction you are thinking in?

MR. THOMAS: Yes, under the conditions that existed in the post-war world they maintained restraints on expansion. They didn't need to stimulate expansion: It developed on a situation. Also, their wages did not rise as fast. They are rising now. Maybe they will all come into adjustment some day.

COMMISSIONER GIBSON: One other question on the limits of monetary policy. This same statement on page 33 says: "It lies beyond the powers of the Federal Reserve to promote growth of particular segments of the economy without affecting other segments

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in ways that may or may not be desirable. It is likewise difficult or impossible to restrain particular activities without exerting general restraint". Your point of view is the quite basic principle that it must be a general approach.

MR. THOMAS: Yes.

COMMISSIONER GIBSON: Not a detailed and selective one?

MR. THOMAS: To use monetary policy for selective purposes cannot be recommended, I think. I was in Sweden in 1955 and they had just appointed a new head of the central bank who was a Socialist, and he immediately started following a more restrictive monetary policy. I talked to one Labour Union economist -- and the Labour Union economists in Sweden are very broad-minded, well informed people because labour really runs the government and they have a high sense of responsibility -- and he said, "We don't object to high interest rates. We just want low interest rates for housing." I endeavoured to explain to him that if you get low interest rates for housing by governmental action you are going to defeat your purpose of restraint on other types of credit, because private money won't go into housing; it will just go into other things. So that, by pumping money in at one place, after it gets there it is going to come out somewhere else and be available for other uses. I think the same thing is true of restraints. It is very difficult to limit the flow of funds into one particular use. We would have various devices -- we

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played around with them ourselves in the late 40's -- and they are called special reserve requirements or marginal reserve requirements where the banks are required to hold certain particular types of assets relative to their total assets, like government securities. In Chile they can hold agricultural credits, and I think in Iceland they hold agricultural and fishery credits. Those are really not restraints. That is really a type of credit expansion, as long as banks can obtain a supply of those assets and can also obtain the cash reserves from the central bank to expand credit indefinitely. That is not a restraint on credit expansion.

Take the simple case of treasury bills: I think you have an understanding you hold 15 per cent in treasury bills, and if there are treasury bills available in the market the bank can go out and buy treasury bills and then can turn around and sell those to a dealer and the dealer can sell them to the Bank of Canada to get 8 per cent cash. You can expand credit indefinitely on that basis. You have to hold a little more cash, you have to hold a little more treasury bills, but it is still part of the process of credit expansion.

It seems to me the basic principle of reserve administration we have always to keep in mind is that to really restrain credit expansion the available supply of reserve assets has to be limited. The banks are required to hold certain reserves. The assets which they acquire to build those reserve requirements

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have to conform fairly closely to the amount they are required to hold otherwise they could go out and get more; as long as they can go out on the market and buy more they are creating money every time they do it. That is the reason the cash reserve requirement, it seems to me, is really the basic restraint that has to be exercised.

I think the British are confused on that; but they are right as long as they limit their issues of treasury bills, but now what is happening in England is that the market itself is beginning to hold more and more treasury bills, so the banks are able to increase their holdings of treasury bills independently of what the government may decide to do as to the supply of bills.

That is the reason we place most emphasis upon the cash or reserve requirement, or the reserve requirement for holding a balance in the Federal Reserve Bank, because Federal Reserve has complete control over that -- I say, "complete" within the limitations of the ability of banks to borrow from the Federal Reserve, which can be restrained to a considerable degree.

COMMISSIONER MACKINTOSH: May I go back to something you said a few minutes ago, Mr. Thomas. Could I fairly infer from your comments on Europe that some of our troubles in North America, you would think, have arisen because we have not been restrictive enough during the period of great expansion?

MR. THOMAS: I don't know that I would

necessarily say that. I don't think we were restrictive enough in the early post-war years. I think we could have been more restrictive without holding back physical growth. A lot of it was reflected in the price increases without stimulating any more growth, but I don't know that that is the cause of the present situation with respect to Europe. I think it is simply that it took time for Europe to get into a position where they could be competitive, and in the meantime that we had built up some price structures that because we were not restrictive enough made it more difficult for us to compete with them. They had about as much inflation as we had in that period -- maybe a little more -- but their price structures are basically lower than ours; their cost structures are basically lower. They were not able to produce the goods until recently, but it does mean that we have to be prepared to make the necessary adjustments to be competitive.

--- Short recess.

THE CHAIRMAN: We shall now resume.

COMMISSIONER GIBSON: Mr. Chairman, I would like to ask Mr. Thomas a few questions about the effectiveness of the monetary policy -- how it works and how it takes hold. On page 29, paragraph 72 at the very end of the second quoted paragraphs under that reference the statement is made that --

> "All of this means that, although monetary policy actions have marginal effects of significance, assessment of these consequences is generally difficult and sometimes impossible. It must be to some extent a matter of judgment".

Now, you have been in the monetary policy business for a long time, Mr. Thomas, and I just wonder if you can tell us about what the Federal Reserve system has done over the years to assess the influence of monetary policy, how it actually works out and how effective it is?

MR. THOMAS: If you sit there and see the day-to-day operations sometimes you think the effectiveness is awfully fast as measured by the money market itself. In fact, frequently monetary policy, the market will reflect policies that have not even taken place yet in anticipation or just on the basis of rumours. But of course that is a more superficial appraisal, it is the immediate reaction of the market to actions or lack of actions or expectations of actions. What you are getting at, I take it, is what is the ultimate effect upon the broad

goals of policy?

COMMISSIONER GIBSON: Yes.

MR. THOMAS: Yes, we are constantly endeavouring to appraise the effects taking into consideration all the other factors in the economy. Take the description that I previously gave of what seemed to happen in 1959.

That is an example of an appraisal of the effectiveness of the policy. I happened to think that it was a very good example of how monetary policy can function in a situation when you have the economy operating at what was in effect capacity and very large credit demands both from private activities and from government and the policy served its purpose of preventing expansion in bank credit.

I am thoroughly convinced that if we had had any easier policy at that time we would have had quite an expansion of bank credit, probably an unhealthy one and the reaction that occurred in 1960 would have been much more serious and prolonged.

COMMISSIONER GIBSON: Well, to put it a little differently, how would you say monetary policy works? On page 48 in paragraphs 115 and 116 you have a reference to interest rates and you say:

> "To a limited extent, the impact of Federal Reserve policies on the economy is effected through interest rates."

And then in 116 you quote the Board's submission to the Commission on Money and Credit and in the first paragraph in that quotation you suggest that interest

goals of policy?

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And then in 116 you quote the Board's submission to the Commission on Money and Credit and in the first paragraph in that quotation you suggest that interest

rates are very important. What I am trying to get is your sort of thinking on how this monetary action pans out and how it changes decisions. You have control, as you say, of the cash reserves in the banking system. This is your primary weapon. How do you believe this goes out and changes decisions to extend capacity? Is it the interest rate structure that is the main factor in this?

MR. THOMAS: Well, I view interest rates primarily as the net result of all factors of demand for money and this available supply of loanable funds at any time and the availability of money through the banking credit system. Credit from the banking system is an important marginal influence there and, of course, affects interest rates. But the more essential feature, of course, is the degree of demand that there is for money. Under certain conditions you have a very strong demand for money and providing additional funds through the banking system may not necessarily reduce interest rates. It may keep them from rising as much as they otherwise would. Of course, if you really attempt to hold down the rates under such conditions by pumping money out you could get an inflationary situation which would stimulate demand and if prices start rising then a rise in interest rates would be inevitable particularly if people think that this may be prolonged.

Higher interest rates always go with inflation. In Germany in the 1920's they pumped money out as fast as they could and interest rates kept going

up and nobody would lend and nobody would borrow. Interest rates have an effect in bringing demand and supply into equilibrium. But independently of monetary policy we want to have an economic situation in which interest rates perform their function in allocating funds within the structure of the economy. As I said, to try to keep your interest rates for housing and let them go up for other things is not generally possible. It can be done to a limited extent but it is done at the sacrifice of some of the other forces in the economy.

COMMISSIONER GIBSON: Have you in the Federal Reserve Board of Governors done much investigation into how changes in interest rates affect business decisions?

MR. THOMAS: Oh, I do not know of any detailed studies of it but just some analytical deductive analyses. I am pretty well convinced that they do have an effect. It may be a marginal effect and again take 1959 we certainly found a very striking example of what 5 per cent on short-term government securities would do in that sort of situation. It brought money into the credit structure out of savings. It induced people to at least shift their funds around from one use to another and no doubt encourage a larger amount of savings certainly in financial forces.

COMMISSIONER GIBSON: You think it did increase the current rate of savings?

MR. THOMAS: I think it did, yes. In fact, it may be one reason for the down-turn in 1960,

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perhaps not the main reason so that we did get some increase in savings. We cannot prove that by the usual national economic account statistics because the ratio of savings to income does not change to me because if savings increase your incomes are likely to go down and then savings will come down so before you get through your ratio by the time you get the quarterly figure, does not change very much because the very fact of an increase in the rate of saving would be to reduce incomes and therefore reduce the actual volume of savings almost correspondingly. Besides this, savings figures are residual anyway and you may never know what they are. Our analysis is more generally based upon the shift from financial assets to fiscal assets of savings, from banks to securities. All those have some effect on the economy.

COMMISSIONER GIBSON: Do you feel there is a good deal of evidence that the entire interest rate structure produces perceptible effects on the current rates of savings?

MR. THOMAS: I think there is a reasonable basis for concluding they do but aside from that you have to consider the alternative, what would happen if, given a situation in which the demands for money are always relative to the supply of savings, if you try to prevent interest rates going up by official policies what would be the result. You always have to know what would happen if what had happened had not happened and to attempt to hold down interest rates

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in a situation where the pressure of market forces is tending to put them up may have highly undesirable consequences and then in the end not succeed in holding them down. The same thing is true in trying to hold them up in a period of slack. You may again not be able to do it.

COMMISSIONER GIBSON: To look at the question in the light of interest rates again, some people have expressed the view -- and this has been expressed before the members of the Commission a number of times -- that the kind of interest rate adjustments that are necessary to produce desired effects over a reasonable period of time are so great that their consequences offset the advantages. Are you prepared to say something about this general subject? I take it you do not agree with that approach?

MR. THOMAS: In general I do not agree because I do not think we know. All economics is a marginal price analysis, what is the effect of prices at the margin and for an economist to say that prices do not matter seems to me to say he is not an economist.

COMMISSIONER MACKINTOSH: It destroys his occupation?

MR. THOMAS: Yes, because economics is a matter of the adjustments that take place in supply and demand and in prices in order to bring about equilibrium. To go out and deliberately try to raise interest rates in order to check demand is one thing; maybe it won't check demand but at the same time to try to put down interest rates when demand is

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tending to force them up would seem to me to be a futile gesture too. So I view interest rates not so much as one of the tools of monetary policy but as one of the results of the situation that results from the availability of funds that monetary policy supplies relative to the demands that are very relative to the availability of private savings. The amount of bank credit that is supplied in any one year is a relatively small portion of the total flows of funds through the Federal market.

In our economy bank credit varies from $5 billion to $10 billion, $15 billion a year and a bit of that is really savings but your total credit is $40 billion to $60 billion in a year. That is the net increase in any one year and interest rates have a great deal to do with the allocation of all that total volume of funds that are constantly flowing through the money stream. It is a little risky to try to manipulate an interest rate structure.

COMMISSIONER GIBSON: When you think of monetary policy you are thinking of controlling cash reserves in the banking system and the interest rates results on this flow from that thinking, they are not a deliberate effort to influence the interest rate structure?

MR. THOMAS: That would be my view. There are people in the system who at times do have a desire to control the interest rate structure. Certainly in the past year or year and a half that has been one of the objectives of policy, to prevent short-term

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interest rates from declining because of the balance of payments situation and the amount of, let us say, volatile funds that were shifted from market to market.

Now, that has been done and short-term interest rates have been kept at a higher level than they would have been under similar domestic circumstances without a balance of payments problem. But the net effect of that on the domestic economy is rather difficult to say. I do not think it has been particularly unfavourable because we have an interest rate structure level that is moderately low considering the state of the world. We have maintained a high level of short-term interest rates.

COMMISSIONER GIBSON: One of the problems we have as Commissioners is to try to see just how this process works. You control bank cash and it has an effect on the short-term rate. If you could say a little more about business decisions and how they react in the face of changes in rates and individual private decisions to spend or to save this would be very helpful because we get out in this area, you know, and people build up the philosophy that people do not pay much attention to changes in interest rates and others say this is the whole thing.

RM. THOMAS: I think it is more availability than rates but I say that rates necessarily have an influence. At some stage it is going to hold back some decision and they are going to postpone a decision. I certainly see it in our market for municipal securities. If interest rates go up issues

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of securities are held back for a period. Now, to what extent that affects their actual spending on public works etc., is another question but it unquestionably has some influence and as I say economics is not an all or nothing business. Again I say it is the marginal decisions that are significant. A difference of one per cent or two per cent in a rate can make a tremendous difference in the state of your economy. I am sure they do have some influence.

COMMISSIONER MACKINTOSH: You say there is some question as to how far this works in this example in the, say, postponement of public works but this ultimately is a real question not only of margin but the margin in real activity on the goods.

MR. THOMAS: Yes.

COMMISSIONER MACKINTOSH: That is in respect of the matter of economic control, and elsewhere we are apt to become rather vague and sometimes fall back on the argument, which I think you nearly made, while you cannot prove that central bank action restrictive or otherwise was very effective, yet there was an overwhelming presumption that if it had acted in the opposite direction in the same circumstances they would have created disaster, which is a kind of modest compliment to the central bank operations.

MR. THOMAS: Yes, it is easy for them to do the wrong thing, but to the extent to which monetary policy is successful there is no evidence that it was needed. But, it is also not altogether a question of postponing a fiscal operation. It is a matter of how that operation was financed; whether you finance it by the creation of bank money, or by drawing in savings to the extent that these municipalities continue to offer their securities, but they attract savings from some other use instead of creating bank money, and some other borrower is deprived of money.

Frequently the view is expressed that monetary policy has more effect in respect of home building than anything else. I think that is an example rather than an argument one way or the other, because it happens that in the Eastern United States home building has been something in which there has been quite a sustained demand, and there has also been a lot of stimulants to financing of building, and

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COMMISSIONER GIBSON: You say you think that it is more availability than rate of interest in the way monetary policy effects spending and investment decisions? Am I correct in thinking that this is another way of saying that the market is not a perfect one, because if it were perfect presumably availability would be reflected in rate of interest?

MR. THOMAS: I would not want to say the market is perfect by any means, but I think availability is reflected in rate of interest; availability relative to demands.

COMMISSIONER GIBSON: But you suggest that some purchasers are not gone ahead with because the funds are not available and have been drawn off in another direction?

MR. THOMAS: And again because they are not available at the rate of interest that they are willing to pay.

COMMISSIONER GIBSON: And accustomed to paying?

MR. THOMAS: And accustomed to paying, yes.

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COMMISSIONER GIBSON: Well, how about changes in capital values? This is really part of the interest rate structure?

MR. THOMAS: Yes.

COMMISSIONER GIBSON: When the rate of interest changes, values change. Do you regard this as a very important way in which monetary policy works and the decisions, negative or otherwise, to which it gives rise?

MR. THOMAS: This is a very important way in which the money market and capital market works, yes.

I would hesitate to say, to admit, to agree or assert that all changes in interest rates are due to monetary policy. There is a proclivity for saying when we have high interest rates it is due to tight money. They are usually due to the money market, not to monetary policy. The way to avoid high interest

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rates under certain circumstances would be to have a monetary policy which would be unsuitable for the situation.

COMMISSIONER MACKINTOSH: Yes, but monetary policy consists not only in doing certain things, but in refusing to do certain things.

MR. THOMAS: That is right.

COMMISSIONER MACKINTOSH: And if the state can raise the interest rates which you think appropriate, then I presume monetary policy permits that to happen?

MR. THOMAS: Yes, let us say it can prevent that from happening only by adopting a policy which would not be appropriate under these circumstances.

COMMISSIONER MACKINTOSH: So it cannot at any time wash its hands of what happens?

MR. THOMAS: For a little while, yes.

COMMISSIONER MACKINTOSH: It can justify the lack of action?

MR. THOMAS: Yes, but later on it comes back and hits you.

COMMISSIONER MACKINTOSH: Yes, I am not arguing that this is not appropriate, I am just arguing that it is not an abrogation of monetary policy.

MR. THOMAS: There is a tendency to blame whatever happens on the wrong monetary policy.

COMMISSIONER GIBSON: I was going to ask you a question that is related to this subject, but in a little different area. Perhaps one of the other Commissioners would like to carry on.

COMMISSIONER LEMAN: There are a couple of

things I should like to have made clear for my own benefit. Did you refer to the fact that you did not think that the rate of savings by people in the economy changed very much from time to time?

MR. THOMAS: I said the statistics do not prove it, but I do not know what is the right conclusion to be drawn from the statistics. If the public spends more and that has the effect of accelerating the economy and producing more income you are going to have more income and more savings, but the proportion of savings to the total income may not increase. It is a question of looking at aggregates for a given period of time without knowing what have been the flows that have taken place within that period. It is a different form of economic image. I do not know what the answer is, but I am not convinced by those people who look at the national accounts figures and say there has been no change in the savings ratio and savings have no influence.

COMMISSIONER GIBSON: Do you regard this as a sort of inflexibility that creates a problem of policy, or the other way around?

MR. THOMAS: No, I do not regard it as an inflexibility that creates a problem. I think there is less inflexibility than appears from the statistics.

COMMISSIONER GIBSON: Now, in this question of dealing with effectiveness, there are two questions, are there not; how effective is it over a period of time, and what is the period of time between the certain action

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at policy level and the end results in the economy? In asking ourselves how effective in point of time it is should we distinguish between the field of capital goods and the field of consumption?

MR. THOMAS: Oh, yes, decidedly, but I am not sure that that in itself is anything that monetary policy can do much about. It is not the function of the banking system to provide long term capital. All the banking system is supposed to do is provide the general short term capital to the extent to which the public wants to hold cash balances. If the public does not want to hold cash balances then the public provides the capital in what other form it chooses to put its balances in. I do not think we should use monetary policy as a way of stimulating capital investment. You have to use it as a means of being sure that there is enough working cash available. The public is going to refrain from investing because it wants to hold cash balances. You have to do it so that also you do not try to stimulate or generally create more cash balances than the public ordinarily wants to hold as a way of stimulating the economy through the creation of short term credit.

Of course, that can hit back at you. It is the supply of savings that has got to determine the availability of long term capital, and the public makes these decisions as to whether it is going to save or not.

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Thomas, about the judgments that have to be made about the rate of growth and the level of spending in the economy. Let us think for a moment of a time when the authorities feel there should be some restraining action. Will the authorities ask themselves if this restraining action should have more effect in the capital sector or in the consumption sector, or should they not pay any attention to that and just look at the total volume of spending?

MR. THOMAS: Well, they have to look at both, yes, but if there is evidence that you are stimulating or creating capital investment at a rate which may not be sustainable, then I think you have to be careful about it. That is about how far you go in that direction. There are times, of course, when consumption may be being stimulated, but you certainly cannot ignore altogether the uses that are being made of credit at any time. There are times when you have to look at particular uses being made of money at an unsound rate. Again you get back to the 1920's. It was perfectly clear; certainly is clear by hindsight and should have been clear at the time, that we had -- I studied the problem carefully once and there was $20 billion of credit borrowing on the stock market in '29. That was one-third of the total of all national credit, and one-third of our national income. It was based entirely on a speculative price rise. That is the sort of a situation that certainly cannot last, and it had to be dealt with.

Thomas, about the judgments that have to be made about the rate of growth and the level of spending in the economy. Let us think for a moment of a time when the authorities feel there should be some restraining action. Will the authorities ask themselves if this restraining action should have more effect in the capital sector or in the consumption sector, or should they not pay any attention to that and just look at the total volume of spending?

MR. THOMAS: Well, they have to look at both, yes, but if there is evidence that you are stimulating or creating capital investment at a rate which may not be sustainable, then I think you have to be careful about it. That is about how far you go in that direction. There are times, of course, when consumption may be being stimulated, but you certainly cannot ignore altogether the uses that are being made of credit at any time. There are times when you have to look at particular uses being made of money at an unsound rate. Again you get back to the 1920's. It was perfectly clear; certainly is clear by hindsight and should have been clear at the time, that we had -- I studied the problem carefully once and there was $20 billion of credit borrowing on the stock market in '29. That was one-third of the total of all national credit, and one-third of our national income. It was based entirely on a speculative price rise. That is the sort of a situation that certainly cannot last, and it had to be dealt with.

That is one example where a selective credit control device was clearly necessary, because we had a credit structure which was built up on too much stock market credit and very much liquid sums held by banks and others were going into the New York money market and loaned for speculative purposes. The imposing of margin requirements would have the result of holding down the demand for that type of credit. Also from experience it has kept the market from doing that for 25 or 30 years, and the development of the treasury bill provided another form of liquid instrument so that the liquid funds in banks and other places did not have to go into that type of call money. That was a case where we needed a selective device. The time might come when you have development in consumer credit, and this might need a selective device, but I hope not because it is a very difficult thing to deal with, certainly in our economy. I think experience has shown that so far it has adjusted itself without being too unsound.

In general I would put more emphasis on the aggregate credit volume and the net result of the money supply rather than on the specific device of credit. The more that goes in to one thing, the less there is for another. The real danger comes when you try to pump it into one particular purpose, or try to keep money going into some, what you consider, justifiable use without restraining the unjustifiable use. You can then run in to trouble.

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COMMISSIONER BROWN: I wonder if I might ask a question along the same lines, and that is, how fast can the effectiveness of some monetary policy change the measure? For example, if you had made a decision based on the available statistics that you use as a measure of intention, and a change in policy is decided upon, what sort of time lag is there? What are the leads that give you some indication that the policy has been as effective as you wished it to be so that you can swing it again?

MR. THOMAS: You can measure it very quickly by the effects on the money market. We can measure it fairly quickly in the effects on the total volume of bank credit and on the money supply. What happens after the money supply has been restricted or extended depends on a whole lot of decisions, and all we can say is that it varies under different circumstances. We know that the rate of turnover of money varies quite considerably. The rate of turnover is not in itself a force, it is the net result of all the other forces other than volume of money and volume of transaction. That requires a very careful analysis of the whole economic structure. That is what is going on all the time. I do not think there is any very precise measure of the effectiveness of what you might call monetary policy that is independent of all the other forces that are operating in the economy at the time. All you can say is that you try to conjecture what would have happened if you had followed a different policy.

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COMMISSIONER BROWN: There is somewhat a similar question in respect of changes in interest rates. That has an effect both on the supply and demand.

MR. THOMAS: That is right.

COMMISSIONER BROWN: To what extent is there also a perverse reaction on the supply in reducing the liquidity of a certain instrument? That is the point I think you were making about the availability of money, rather than the rate of interest?

MR. THOMAS: Well, of course, any change in the price, or any tendency for the price to move in one direction or another always has an expectational effect. Sometimes you are getting a rise in interest rates or a decline in bond prices which will not immediately stimulate lending because people buying bonds will wait until they think the price has gone down to what they consider to be as far as they are going to go.

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The participants in the market will do that, and that is one of the arguments against a deliberate policy to peg an interest rate or the price of bonds because it may actually keep people from buying who otherwise would be in there buying, because they think this is an artificial price and they will not buy at this level.

At the same time it might stimulate borrowing because people say this is an artifically low interest rate and we had better get the money while we can get it, so it does have reverse effects, and any process can change in a market situation and while the change is going on it tends to have that effect. That is just one of the market characteristics, and it is judgment of the market-place as to when is an appropriate to buy, to borrow or to lend.

COMMISSIONER GIBSON: I have a couple of more questions to do with this area and to do with the timing, really. How about the problem of knowing enough in order to take action quickly. Is this the constant problem of being a little late, not having enough information to do what should have been done in time?

MR. THOMAS: Yes, there is always that problem. Sometimes you get leads from the market itself. That is what our people in New York call "operating on the feel of the market". You can get action on the market that you cannot explain on the basis of statistics that are available and that would indicate some new factors are coming in; the year-

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round treasury bills or this, that, or the other.

COMMISSIONER GIBSON: It is the feel and flare, is it?

MR. THOMAS: Yes, so again it is a matter of judgment; if you think it is reasonable to accept a certain response under the circumstances and you begin to get that indication in the market, then you might be willing to act a little more promptly.

COMMISSIONER GIBSON: Perhaps ahead of the others?

MR. THOMAS: Yes, perhaps ahead of the others.

COMMISSIONER GIBSON: Does this happen fairly frequently?

MR. THOMAS: It does happen. Sometimes it is a mistake; sometimes the development that you think will take place does not come about.

COMMISSIONER LEMAN: The flare gets ahead of their feel?

MR. THOMAS: There is always a tendency for anybody operating in a market to be very much influenced by a temporary factor. That is one reason why we sit in Washington in our marble palace -- or mausoleum, some people call it -- and try to get a broad view and hold back those in New York who are very much influenced by the market psychology.

COMMISSIONER GIBSON: Is there not some difficulty about convincing this group that make the decisions about the growing policy -- as you described earlier -- to do something just on the feel of the

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COMMISSIONER GIBSON: Is there not some difficulty about convincing this group that make the decisions about the growing policy -- as you described earlier -- to do something just on the feel of the

situation and have not got the statistics and factual data to back it up?

MR. THOMAS: Yes, there is always that difficulty and frequently there is some lag, but I do not know that these lags become too important because there is so much day to day adjustment that the actual operations which can be said to affect policy are very small.

I can use this illustration; suppose you have a rate of growth of 3 per cent a year in money supply. That involves an addition to the volume of bank reserves of something like $500 million or $600 million in a year, and the volume of currency of about the same amount, it means about a billion dollars of reserve bank credit, and that is only $20 million a week, and to take care of normal growth in operations which run as much as a billion dollars in either direction in any one week, $20 million is a very small fraction.

What we have actually done is we have given the Committee our projections of what the reserve needs may be and we frequently put in a factor for growth or a factor for the side growth.

Now, I think just about a year ago, looking at the situation, we were in a period of recovery and wanted to know how much money we would be putting into the economy and I figured roughly, well, 5 per cent for the period of recovery, 5 per cent annual rate of growth, and we put that in as a projection for the amount of reserves that might be supplied in addition

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to the weekly, seasonal and other temporary variations, and projected that on through, and that level has just about been sustained.

Now, there is an interesting sidelight on that in the sense of how you cannot be sure of what the effect will be. The result of the 5 per cent increase in reserves, the annual rate of increase in reserves, was only about a one per cent increase in demand deposits and a 16 per cent increase in time deposits. The reserve was there, the money was created, the bank credit expanded at the rate of about 8 per cent, but the public made its own decision as to how it was going to hold that money. They did not put it in what we call "money supply", they put it into time deposits at banks, and it was one of the difficult questions of judgment and is still a difficult question of judgment as to how much weight to give when the public is holding time deposits and not demand deposits. How do you measure the money supply? You measure it by the total time and demand deposits, which will have a tremendous expansion of 7 or 8 per cent and the 5 per cent reserve is less than the seven or eight because of the lower requirements against time and deposits. If you measure it by just what we call the active money supply, it looks as though we have had an inadequate growth. That is still one of the debated questions.

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Now, we have a new situation that is added; that the treasury has been increasing the supply of

treasury bills outstanding at the rate of 100 million or 200 million a week, and although banking credit is expanding some it has not expanded much because the public is buying these treasury bills and it has kept the bill rate up -- it is close to 3 per cent now -- and corporations instead of holding cash in the banks or on time deposits or something else, they are buying treasury bills or somebody else is buying treasury bills, but that is liquidity and it is available for use and it comes back into use and then when somebody tries to convert it back from bills into cash, then a decision will have to be made as to what the monetary policy will be. So far most of it has gone to expand the treasury balance, so it has not come back into the money supply, but once the treasury spends it it will be a question of what the net effect would be.

These are all matters that require judgment in any given situation. There is not any pat answer to it and it has to be viewed in the light of the economic climate at the time.

COMMISSIONER GIBSON: There is one more question to do with the effectiveness of policy, and that is when you want to add cash to the system and the business is well below capacity, are you prohibited at times from adding as much as you would like to do and it may be hard to get the liquidity out of the system later on in the cycle when business is good.

MR. THOMAS: There is always that reason, but in 1954 and 1958 the system was not inhibited by that

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fear, and in 1958 it came back and hit us pretty hard when a change occurred and pumped in a lot of money in that period. It got just to the point where banks and others finally decided that maybe interest rates were going to go lower, or at least they had a lot of money available and were going to put it into something that would give them a better yield than treasury bills, which were down three-quarters, or something, and just about the time they started shifting the market changed and the treasury put out an issue of long term securities and the whole psychology changed, and you had a little experience here about that time, you put through a big refunding operation just at the time when the industries changed and had the Lebanese and Syrian flare-up, and there was a very sharp change in the economy and in the whole level of interest rates and prices. Therefore, you look back in hindsight and maybe you can say that a lot of that money that was pumped in was not necessary.

Now, in 1960 and 1961 we refrained from pumping in a great deal; refrained because of the balance of payment situation. There is no evidence that failure of treasury bill rates to go down very low and to build up a whole volume of funds had any serious effect on holding back the economy. The recovery has given consideration to other factors and it has been not much unlike that which took place in the other period when you did not have this wide fluctuation in interest rates and upsets to the bond market.

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THE CHAIRMAN: I think that people are having a little difficulty in hearing you.

MR. THOMAS: I am sorry.

COMMISSIONER GIBSON: This is one of the reasons that you have this factor in mind of not putting too much money in to stimulate recovery for fear it may provide too much later. This boils down, from what you were saying, to part concern about too rapid changes in interest rates to correct the situation, is that correct?

MR. THOMAS: Yes, too rapid change in interest rates or, putting it the other way, too rapid change in bond prices.

COMMISSIONER GIBSON: Yes.

MR. THOMAS: Rapid change in short term interest rates does not do any great harm; the economy can adjust to that pretty quickly, the money markets and security markets can adjust to the short term interest rates because that has very little effect on capital valuations of the securities involved, but changes in long term rates which are likely to accompany it can be more upsetting, but whether it should be avoided I think is a question for debate.

In a way one could argue in a period of slack that it is all right to encourage the public to buy long term securities, and then when you get into a period of boom, the fact that they hold these and they are at a lower price is in itself a restraining influence. This is one of your automatic stabilizers and that might be desirable, and is to some extent.

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COMMISSIONER GIBSON: But you do feel that you can have too much change in long term interest rates?

MR. THOMAS: Yes, if your cycle is a short term cycle, you get into a long sustained depression period and long term -- it is desirable that long term rates come down.

COMMISSIONER GIBSON: But what is your objection to big changes in interest rates, that it upsets the investment decisions too radically and you get the first reactions if you get a lot of large changes in a fairly short time?

MR. THOMAS: Yes, it is upsetting to the market, and if the adjustments occur in the early stages of the recovery it might actually retard the recovery, and they might occur in the early stages because people think the activity is going to increase and there will be more pressures on the markets and they think that bond prices will change and they will anticipate that change, but I certainly would not be dogmatic about it and I am not sure that I would want to advance it as my view, and I am not sure of the view that we should have more moderate fluctuations in interest rates; maybe we should not. I think you can argue either way.

COMMISSIONER GIBSON: We have had a lot of witnesses that felt that fluctuations in interest rates should be much more moderate.

MR. THOMAS: The market people always feel that way. You can get an economist who might feel the

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other way; people who want to really follow positive programs of stimulating the economy in a recession and restraining it in booms and they might argue for wider fluctuations in interest rates and availability of funds, which would have the result of causing wider fluctuations in interest rates. Generally these people would like to have interest rates go down, but never like to see them go up.

COMMISSIONER MACKINTOSH: If I could inject a question, is it not possible with fairly violent fluctuations in long term debt securities that you destroy the place of those securities in various investment portfolios and that you in many cases lock them in?

MR. THOMAS: Yes.

COMMISSIONER MACKINTOSH: And destroy their effective marketability and that you may get a long run shift away from them, even government securities. The ultimate security is there, but the availability of them is quite different from what people contemplated when they put them in those portfolios?

MR. THOMAS: Well, I don't know that that is avoidable if the price system is going to function and reflect the changes in supply and demand forces, but it is an argument against encouraging too wide movements, probably, or unnecessarily wide movements, but when we get into recession and the demands for credit are slack, banks are going to gradually look for the most profitable things they can find, or other investors are going to, and that will tend to push down rates, and to try to keep them from going down I am not sure [illegible] is sound policy under the circumstances. As I said, to the extent to which they can be locked in in a boom, maybe it is a good thing. We tried in 1947-1948 to prevent bond prices from going down, and insurance companies and other investors were trying to move out of government bonds into other securities, and the Federal Reserve bought $10 billion worth of bonds in that endeavour, which just helped to create more money and to bring on an inflationary situation. It might have been better to let them be locked in.

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acceptable?

MR. THOMAS: People who make their living in the market have a tendency to never like to have markets work the way they are supposed to work in order to perform their function.

COMMISSIONER LEMAN: Mr. Thomas, in one of the objectives, if I may come back to it for a second, is the reasonable stability in the purchasing power of the currency -- avoiding inflation and deflation. Ultimately, what the people want are goods and services, and those are the prices you are referring to there, but if as a result of habits in the economy people hold long-term securities, to them they may have held them in order to use them later for the purchase of those services; right?

MR. THOMAS: Is that your question? Aren't you going on with some other conclusion or question?

COMMISSIONER LEMAN: Yes, I would like to go on from there. I am just wondering ---

MR. THOMAS: I am not going to agree that you are right at this stage. I just want to see where you are leading.

COMMISSIONER LEMAN: If you believe it is not right, I wish you would tell me right now.

MR. THOMAS: Well, I want to see where you are leading.

COMMISSIONER LEMAN: I am wondering if that is basically the reason why people argue against quick or violent changes in prices of bonds?

MR. THOMAS: Of securities?

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COMMISSIONER LEMAN: Mr. Thomas, in one of the objectives, if I may come back to it for a second is the reasonable stability in the purchasing power of the currency -- avoiding inflation and deflation. Ultimately, what the people want are goods and services, and those are the prices you are referring to there, but if as a result of habits in the economy people hold long-term securities, to them they may have held them in order to use them later for the purchase of those services; right?

MR. THOMAS: Is that your question? Aren't you going on with some other conclusion or question?

COMMISSIONER LEMAN: Yes, I would like to go on from there. I am just wondering ---

MR. THOMAS: I am not going to agree that you are right at this stage. I just want to see where you are leading.

COMMISSIONER LEMAN: If you believe it is not right, I wish you would tell me right now.

MR. THOMAS: Well, I want to see where you are leading.

COMMISSIONER LEMAN: I am wondering if that is basically the reason why people argue against quick or violent changes in prices of bonds?

MR. THOMAS: Of securities?

COMMISSIONER LEMAN: Or securities.

MR. THOMAS: It seems to me this gets down to the fundamentals of the whole process of saving and investment and liquidity. The economy has to operate. If it is going to grow you have to have investments and we have to have savings that correspond to it, and somebody has to hold those savings and those investments, but if all savings are always liquid, then they own money, and you can't be assured that all savings are going to be always so liquid otherwise you are going to have a very unstable economy. The whole function of savings is that a certain amount has to be held, and anyone who wants to convert his savings into money has to run the risk of the market at the time and find somebody else who will take over those assets and use his savings for that purpose. But if you set up a public policy of guaranteeing the prices of all assets, then you are just running a printing press. Every time anybody wants to shift out of one asset into another, and you are going to guarantee he can do that at a price he thinks is reasonable, then you are not following a policy that will provide a reasonable stability in the economy. It is going to provide very wide fluctuations. We know it from experience; we have tried it.

The question is, how much liquidity should the economy have at any given time. A certain amount of savings just cannot be liquid -- not at a fixed price.

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The question is, how much liquidity should the economy have at any given time. A certain amount of savings just cannot be liquid -- not at a fixed price.

COMMISSIONER MACINTOSH: I would like to

explore a few different questions that have been touched on already, Mr. Thomas. You emphasize repeatedly through your brief that the primary concern of the Federal Reserve Board is in the amount of bank cash, and that that is the thing which you can influence most firmly and most precisely, and subject to the qualifications you have made to place rates of interest in a sort of secondary position exercising to a degree a function of communicating the availability of cash to the various parts of the capital market.

MR. THOMAS: Allocating.

COMMISSIONER MACKINTOSH: Allocating. I noticed in the evidence before the Radcliffe Committee there seemed to be a sharp division, which is not unusual among economists, some of them asserting with great dogmatism that if you controlled liquidity you need not pay any attention to rates, and others were equally dogmatic that if you can set the structure of rates you don't need to pay any attention to liquidity. I take it your view is that these two things are tied up and that the structure of rates will flow from all the factors in the market plus the degree of liquidity.

MR. THOMAS: Yes, that would be my view. I do not think you can separate liquidity and interest rates. They are all inter-related. If the liquidity is increased it will have an effect on interest rates. To try to fix interest rates without regard to liquidity would also be futile except to the extent to which there are institutional practices, like the

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Bank of England can change its bank rate, and certain other rates automatically change accordingly. But I would say that if the Bank of England changed its bank rate to a level which was unrealistic in view of the state of the economy and the demands for credit, that the rate would be ineffective and there would be leakages through one device or another that would mean it would not work. Some of those leakages would be through the international markets.

COMMISSIONER MACKINTOSH: And more immediately if it fixes a certain rate it is only made effective through open market operations ...

MR. THOMAS: Which affects liquidity.

COMMISSIONER MACKINTOSH: ... which may in turn break down because of the international ---

MR. THOMAS: Which affects liquidity.

COMMISSIONER MACKINTOSH: Yes. There is quite a volume of literature and discussion on policies variously described as bills only and bills preferably, and so forth. I take that this is still the policy of the Board, subject to somewhat uncertain modifications from time to time; is that reasonably correct?

MR. THOMAS: I will speak personally: You see, I am a bills only man, pure and simple. I think that the policy of bills only or bills preferably or bills usually is essentially so unavoidable for very practical as well as for theoretical reasons with possible variations, which we can discuss, one reason being that, as I have pointed out, the volume of Federal Reserve operations in the market is very large.

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We buy and sell something like $10 billion worth of securities every year, whereas the net change in the system holdings may be negligible -- may be one billion or two billion at the most depending on how much has to be used to offset gold movements. So that, you have to buy something that you can sell, and quickly. They sometimes buy $1 billion of securities one week and they sell the same amount the next week to take care of seasonal needs. So, the Federal Reserve prefers bills because the market prefers bills. Bills are more easily sold in the market than other securities. We have a big portfolio, even though on rather short-term securities -- what we call certificates which are issued to mature in less than one year, and notes issued to mature in less than five years, and constantly approaching maturity. However, we are practically never able to sell any of those securities in the market. We can always buy them, but we cannot always sell them. So, most of our operations have to be in bills, and I think there is general agreement on that.

COMMISSIONER MACKINTOSH: This is the more nearly perfect market.

MR. THOMAS: It is the more nearly perfect market. It is the biggest market; it is the market in which you get the minimum of price changes. You can run off a bill one week, if you have one in your portfolio, and make an adjustment that way. So that in order to operate in the market and supply the reserves that are needed with the minimum price effects,

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other than the price effect that is desired at the time, you have to operate on something in which there is a very good market. Therefore, for very practical reasons most of our operations have to be in bills.

Now, to the extent to which you can find an occasion when you buy some other securities, it is all right -- our portfolio is $25 billion and we really, I think, hold only $3 or 4 billion of bills, actually, and we are able to do all this on that small amount of bills, and it does not make a great deal of difference how the others are held. A lot of these have been acquired over a period of time. As I said, in 1948 we bought $10 billion worth of long-term bonds and still have a lot of them. Others are approaching maturity or have matured. However, to go more into the broader aspects of it, I think the question again gets back to a question of liquidity: How much liquidity you want in the economy. If we have a situation in which there is inadequate liquidity in the economy, in which we have a public debt that has a lot of long-term securities outstanding, and the treasury is not able to increase the supply of liquid instruments by issuing shorter-term securities to replace those that are maturing, or you don't have enough approaching maturity to provide the liquid instruments that our markets would like to have, there might be a case for the Federal Reserve buying up some of the longer-term securities that the public holds and increasing liquidity, which is the same as if the treasury could, say, have some advance refunding, or

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call some issues, and issue some short-term securities in its place. You can do it by either process. It is a question of the change in the structure of the public debt that is outstanding.

Because from the standpoint of the economy the debt that is held by the Federal Reserve is not essentially the market supply, it is not debt that has been used to absorb savings or, to get back to another fundamental, the whole purpose of public debt and in issuing long-term securities is to finance the government's deficit by borrowing available savings without creating money, creating additional liquidity and whether the Federal Reserve holds a long-term security or a short-term security does not make any difference as far as that goes because the Federal Reserve is not going to buy securities except for other purposes. It does not make any difference whether they are liquid or not provided it has enough to do its current operations.

So you have to view the debt outside the Federal Reserve and outside of the treasury operations from the standpoint of the effect of this debt structure on the economy and savings and the investment and liquidity situation at any particular time. The only occasion for the Federal Reserve to buy long-term securities, then, is in case you want to increase the liquidity at a time when you cannot do it by any other means. We have not been in that situation in our public debt structure. Our public debt structure is over-balanced towards the short-term end rather than towards the long-term end.

COMMISSIONER MACKINTOSH: I was just going to ask you do you visualize a different set of circumstances in which public debt has a considerably longer average maturity than is true in the United States and where

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COMMISSIONER MACKINTOSH: I was just going to ask you do you visualize a different set of circumstances in which public debt has a considerably longer average maturity than is true in the United States and where

the short-term market is less fluid and concentrated than it is in the United States. May not in those circumstances a bills only policy be impractical?

MR. THOMAS: Well, I can conceive of a situation where that could happen but generally the aims of most governments since the war have been to get their debt extended rather than to shorten it. Let us take the other side ---

COMMISSIONER MACKINTOSH: You say their aims have been to get it extended?

MR. THOMAS: Get it lengthened rather than shortened because debt matures awfully fast -- the passage of time itself.

COMMISSIONER MACKINTOSH: That is true but they are not always successful in extending it.

MR. THOMAS: No, that is what I say. That is one reason why if the Federal Reserve or central bank ever buys long-term securities it is going to be exceedingly difficult for it ever to sell them because the treasury can always sell them and would always be willing to sell long-term securities if the economic situation is such that it is desirable to absorb savings and reduce the liquidity of the economy. The treasury can do that through its debt management and build up and improve its debt structure but for the Federal Reserve to attempt to sell long-term securities at any time would simply make it more difficult for the treasury to improve its own debt structure.

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Reserve operations in short-term securities are not only practically necessary, they are almost unavoidable. There is seldom any occasion when there is any reason for trying to operate in longer-term securities. The basic thing is that the net effect of Federal Reserve operations is not the small amount of securities it buys and sells and the effect on the market at that time; it is the ultimate effect of the multiple expansion of credit or the multiple contraction, as the case may be, as that money flows into other people's hands.

When the banks get the reserves they are the ones who decide how those reserves are to be used, they together with the borrowers, and when the borrowers get the money and spend it the ultimate recipients are going to decide how that money is going to be used and you can get some tremendous repercussions that are completely out of control of the Federal Reserve and they have a great deal more influence on the market structure of rates than simply the initial purchase by the Federal Reserve.

The Federal Reserve affects the market structure. It affects it more through its indirect effects. It is the decisions of the ultimate recipients as to how they use the money more than by the initial transaction in itself.

COMMISSIONER MACKINTOSH: Does the Board limit its views on the amount of additional or subtracted credit which it feels is desirable in the system or bank cash or does it take a view of the

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COMMISSIONER MACKINTOSH: Does the Board limit its views on the amount of additional or subtracted credit which it feels is desirable in the system or bank cash or does it take a view of the

desirable structure of interest rates even though it does not attempt to operate on them?

MR. THOMAS: I would say that the prevailing view is that there is not much they can do about the structure of interest rates. Take in the last year, there has been an endeavour, as I have said, to maintain the level of short rates and there was a sort of view expressed that they were going to keep short trates from going down but still push down long-term rates.

COMMISSIONER MACKINTOSH: This was operation nudge, was it?

MR. THOMAS: Well, I think the initial author of the word "nudge" would not have carried it to the point of saying you could hold up short rates and push down long rates at the same time. He would have used it in the sense of being in a situation where long-term rates are tending down anyhow and you can make them go a little faster if you operate in that area. But to try to operate in one area in one direction and in another area in another I do not think he would recommend any such thing and he certainly did not have that in mind. It is not a rational implication of the use of the word "nudge".

COMMISSIONER MACKINTOSH: It is not a very precise term?

MR. THOMAS: And, of course, what has happened is that we have, as I say, held up short rates. Part of that is due to the fact that the treasury is pushing the low short-term securities. I think that has more to do with it than any Federal Reserve

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The only way you can get longer rates down is to push short rates down so that people would sacrifice liquidity in order to get yield.

COMMISSIONER MACKINTOSH: On that point, assuming the Board increases bank cash and considers that an appropriate result of that and an inevitable result probably would be a reduction in all interest rates, but did not interfere with the structure -- they left the market to take care of that -- is it possible that you would have to, in order to obtain the desired effect over the whole range, push short-term rates lower than if you operated over the wider band?

MR. THOMAS: Well, that is a matter of opinion. I would say no. Yes, I would say that if you operated over the wider band short rates would go down just as much as if you operated entirely in the short-term area.

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From the standpoint of the Federal Reserve loans our operations are not enough of an influence on the whole market to affect the structure very much. It might temporarily. I mean, if you went out and bought -- in order to meet Christmas currency demands you went out and bought long-term bonds of course you would push the bond price down quite low. But you would also bring bonds out at a rapid rate. I know one security dealer when this operation nudge was being talked about who said he had a supply of bonds and he offered them to the Federal Reserve and they bought a little bit. Then he came back and he offered a great deal more and they changed the price on him and he was sore. He was one who was against the operation and he was endeavouring to show what would be the effect of it. I don't know that it was deliberate but he was going to take advantage of it and get rid of some bonds at a good price and he was convinced there were plenty of bonds that would be available if the system really tried to push the price up and the yield down. With the volume that is outstanding in the market you could buy indefinite amounts.

Again going back to 1948 we bought $10 billion worth of long-term bonds and sold $10 billion worth of bills and the bill rate still stayed low relative to bond yields.

COMMISSIONER MACKINTOSH: On one of your earlier illustrations where you spoke of municipal capital expenditures being affected, clearly affected

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COMMISSIONER MACKINTOSH: On one of your earlier illustrations where you spoke of municipal capital expenditures being affected, councils affected

by interest rates ---

MR. THOMAS: Maybe you are making it stronger than I intended. I would not use the word "clearly".

COMMISSIONER MACKINTOSH: Well, I am sorry to put that word in the mouth of a banker.

MR. THOMAS: Thank you.

COMMISSIONER MACKINTOSH: At any rate you indicated some influence there. Now, that implied that if you are increasing the amount of bank cash for the purpose of affecting the economy you want that effect to fan out as far as municipal bonds.

MR. THOMAS: I am not too sure of that, that you want it to fan out that far unless the public is willing to put its savings into bonds but they have to make the decision. The public has to make the decision when it wants to buy bonds with its savings.

COMMISSIONER MACKINTOSH: That would prove that your action was really directed towards biasing the public's decision a bit?

MR. THOMAS: Yes, it is to encourage them to venture out. I think that is right. It is quite a different thing from the Federal Reserve going out and buying the bonds directly, though.

COMMISSIONER MACKINTOSH: Oh yes, I was not suggesting that but you do depend on this spreading through the whole interest structure, it is the fairly long drawn out effect that you are looking for.

MR. THOMAS: Yes.

THE CHAIRMAN: I think this may be an appropriate time to adjourn until 2.30. Will that

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THE CHAIRMAN: I think this may be an appropriate time to adjourn until 2.30. Will that

give you sufficient time?

MR. THOMAS: Yes indeed, I am at your disposal any time.

--- Luncheon Adjournment.

--- Upon resuming at 2.30 P.M.

THE CHAIRMAN: We shall now resume.

COMMISSIONER MACKINTOSH: I just have a question or two, Mr. Thomas with reference to the so-called operation nudge; am I correct that in part this was undertaken in order to maintain a relation between New York rates and European rates which would discourage the outflow of short-term capital?

MR. THOMAS: Oh, definitely it was part of the effect that brought about the decision. Whether there might have been a change otherwise, I do not know, but there was sufficient to make the committee willing to venture into other procedures, yes.

COMMISSIONER MACKINTOSH: Whatoccurred to me was that the United States has been in the past years much less affected by international markets than many countries. We, on the other hand, have lived in a fairly vulnerable position as far as short-term movements and capital. Does this mean that we in this country for this reason have to take a different view than operations restricted to the short-term market?

MR. THOMAS: I should not think so.

COMMISSIONER MACKINTOSH: Well, is there a peculiar set of circumstances in the United States?

MR. THOMAS: Well, I would say that actually in the United States the situation has not really changed very much. They have conducted very few operations other than in the short-term market.

--- Upon resuming at 2.30 P.M.

THE CHAIRMAN: We shall now resume.

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They have not found it necessary or possible even. All or most of the reserves that have been supplied have been purchasing stocks in the short term area, but there were some in the Spring a year ago; a few purchases. The treasury purchased a little bit. At the same time the treasury was engaged in the advance refunding operations and had a lot more in the long term area. They purchased some long term securities. That may have given a little help to the market. The anticipation may have given some help to the market, but the policy was never carried far enough to have any very important effect on the long term rates.

As I say, the policy has been to prevent short term rates from rising. The Federal Reserve formally followed a bill's only policy. It has recently been following a bill rate only policy. The chief objective was to keep the short term bill rate from getting down below some point at which it would encourage the outflow of funds. At the same time the policy has been to endeavour to supply reserves to help stimulate the domestic economy which is in a state of slack. So, what has happened is that the system has in fact bought all these securities that the market wanted to sell in order to keep reserves that the market wanted to use, but the system has not gone out and bought aggressively to the extent of pushing the bill rate down. When the bill rate started going down they held back. The result has been that the banks have obtained all the reserves the banks themselves

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wanted, or the market wanted, without the system actually forcing reserves on them, which has had the result, as I summarized this morning, of giving quite a substantial expansion in bank credit, about $16 billion last year, and going at about the same rate this year, which is about 7 per cent. Most of it has taken the form of time deposits rather than demand deposits. I think that is pretty much the policy that is still being followed.

COMMISSIONER MACKINTOSH: Have related operations included operations on the forward exchange market at all?

MR. THOMAS: There have been some operations on the forward exchange market, mostly by the treasury. I think there is some by the Federal Reserve, but the system adopted the policy of operating in the forward exchange market at about the time I retired, and this is very secret, what they do there, and I am not informed as to what actually is being done.

COMMISSIONER MACKINTOSH: That is all I have, Mr. Chairman. Perhaps some of the others have questions in this area.

COMMISSIONER LEMAN: Mr. Thomas, I should just like to refer for one second to paragraph 123. This follows on from what Dr. Mackintosh was asking you about, and what we have been talking about. I think it is a quotation, actually. It reads:

"International movements of funds that can be attributed to --"

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MR. THOMAS: No, that is not a quotation.

COMMISSIONER LEMAN: No, that is not a quotation, it is your own text.

MR. THOMAS: I will assume the responsibility for it.

COMMISSIONER LEMAN: It reads:

"International movements of funds that can be attributed to interest rate considerations may call for policies aimed at influencing interest rates, especially if they can be effected without long-run damage to the domestic economy."

When I read this I thought that the conclusion to be derived from it is that you would not be averse to trying to influence the structure of interest rates for that purpose and you apparently visualize conditions under which this could be done without long-run damage to the economic area. Can you tell me what are the type of conditions which you feel would permit such an operation?

MR. THOMAS: I think this is maybe what I might call the official explanation of the policy that was undertaken, but actually very little has been done to influence the structure of rates as such except to prevent the short rate from going down. Very little has been done to actually push down the long rate, although a little bit was attempted there which probably may have had some effect in stimulating the capital markets in the Spring of last year when there was a

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very large volume of securities issued. If it had been pushed far enough to actually try to get the long rate down while keeping the short rate up, it might have done some damage to the economy.

What this refers to more is that an attempt was made to keep the short rate from going down but still make reserves available under the conditions that were prevailing at the time, but not to push reserves out. It was the policy that might have been followed if it had not been for the international situation. If it had been just the international situation alone and we had been in a booming economy we would have let the rates go up much faster than this, faster than they actually did go up.

COMMISSIONER LEMAN: But if you had been in a booming economy you probably would not have had that international payment problem, would you?

MR.THOMAS: That is a question. I do not know. I am not sure, but we could have had.

COMMISSIONER LEMAN: Well, I am really wondering what is the long range damage to the economy; the type of damage you visualize?

MR. THOMAS: Well, to follow a tight policy under the circumstances might have, or would have had a long run damage to the economy. If you had really pushed rates up far enough well, this would have stopped the outflow of funds and might have damaged the domestic economy.

COMMISSIONER LEMAN: Oh, yes, I understand that, but I was thinking more in the following terms.

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COMMISSIONER LEMAN: Oh, yes, I understand that, but I was thinking more in the following terms.

If the Federal Reserve decided at one point to influence the structure of interest rate by changing the spread between the longs and shorts; that type of operation is what I had in mind.

MR. THOMAS: Well, what this phrase refers to and what I said was, it was an attempt to keep up the level of rates as high as possible without being too restrictive on the domestic economy at the time. Whether they could ever have followed a policy of changing the structure of rates contrary to the market forces, I do not know. It was not carried that far. What the effect would have been, nobody knows. I have an idea about it. My own view is that it could not have been successful and we might have had to buy a whole lot of long term bonds and still not have been successful.

COMMISSIONER GIBSON: Mr. Thomas, I was interested in the way you described the bills preferably or bills only policy largely in terms of practical considerations on the monetary policy. I have heard it described in more emotional terms by people who are concerned about the central bank and expressed the view about the interest rate curve, and feel very strongly that it ought to stay in the short end of the market, but argue that if the central bank intervenes in those areas of the market this creates a state of uncertainty which is not beneficial to a healthy market. Would you care to say a word about this?

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MR. THOMAS: I think that is one of the

factors, but that is a more subtle one. I prefer to put it on practical grounds because it is better understood. This becomes more theoretical, but I certainly think it is true that if the central bank tries to intervene and determines a level of rates which have not been determined by the prevailing market forces it can get into quite serious difficulties before it is over. We have the illustration of the 1948 situation; the illustration I gave of the dealer who was standing there ready to sell us as many bonds as we would have, and I think there were lots of others who would have come in if they felt that the system was really trying to maintain what was an artificial level of rates on long term securities.

COMMISSIONER GIBSON: So that on basic philosophical grounds as well as practical grounds you favour this policy?

MR. THOMAS: I favour the policy of limiting operations to short term securities.

COMMISSIONER GIBSON: Yes.

COMMISSIONER BROWN: In that connection it has been suggested to us, Mr. Thomas, that when the central bank does get into this wide spectrum of operations it has a tendency to discourage dealers who would normally carry a large inventory from carrying a large inventory, and tend to make the market thinner. Would you like to comment on that?

MR. THOMAS: I think that would be the tendency. We have no statistics from dealers. We

did not put them on a comparable basis for a very long period before these operations began, only September to about February. We have had it varied since, in February a year ago.

There is little indication that the dealers' positions in those long term securities are more than they were before. It is awfully hard to generalize on the basis of such a limited period because there are all these other factors which determine dealers' positions. We have found that when the treasury puts out a long term issue the dealers have increased their position. In fact, in October last year they built up a fairly large condition in some long term issues that the treasury was issuing. Some of them lost money on it. Some of them were inclined to say that the Federal Reserve did not live up to its promises to support the long term market, keeping the rate down or pushing it down, and they went in there and bought these on the grounds that they could not lose. I would not be prepared to be dogmatic, but I think the presumption is that the dealers definitely say that the market is less certain, but a bond market is always uncertain. They have always complained about there being no bond market, and they cannot sell any number of bonds they want at the price they want to get, but that is the nature of the bond market, or any market for long term or fixed value assets. You always have to wait and you have to find a buyer. There are just not that many buyers around, and it has to be a negotiated sale. You always find people com-

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plaining about the thinness of the bond market. I suspect that our government bond market is one of the most active markets in the world from the standpoint of transactions. If you take the larger end, the volume of operation that goes on in the government security market, leaving out bills in dollar amounts it is many times greater than the daily operations on the stock exchange. There is a tremendous amount of money that changes hands there every day.

COMMISSIONER BROWN: I should like to switch over to a slightly different aspect of this question on debt management. I was wondering if you would review for us in a certain amount of detail the division of responsibility for debt management and how the treasury and the Federal Reserve is co-ordinated.

MR. THOMAS: Well, the responsibility for debt management is entirely with the treasury. The Federal Reserve banks act as fiscal agents for the treasury and carry out some or most of the physical operations of collecting money, issuing securities and that sort of thing; receiving subscriptions, and certainly the Federal Reserve bank in New York and at times others as well as the board itself will advise the treasury as to the state of the market and as to the possible issues that they might put out in time issues. The treasury will take into consideration the state of the money market and the reserve situation that might develop at the time, but

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the decision is a treasury decision, very definitely. Any operations that may take place during a period of treasury financing, being aware of stabilizing the market, are likely to be treasury operations. The Open Market Committee had a working rule that during a period of treasury financing the system would engage in no operations which would have the effect of changing the level of interest rates during that period and, to some extent, the system goes a step further in an endeavour to maintain a fairly even situation in the market during that period. So, if any special factors come up that influence the market during the period when the books are open on the treasury finance -- maybe even for a short time afterwards and before -- the system endeavours to maintain an even situation in the money market just as it does at Christmas time when we have large currency demands, as well as in respect to other temporary factors that affect the demand for or the supply of money, or need for reserves, and endeavour to smooth this out, if we know that they are temporary, at the same time trying to avoid getting into a situation of actually supporting the treasury issue.

Now, for the first few years after the treasury Federal Reserve the Board in early 1951 did follow the policy of actually supporting the treasury issue after it was announced and before the subscriptions came in; at least, any issue that became weak.

Now, during that period the treasury was following the policy of pricing their securities rather close to the market; that is, of offering a rate that would give a very small advantage to the subscribers and frequently the result was that a lot of the holders -- if it was an exchange offer -- a lot of the holders of the outstanding issues that they might be offered in exchange, would sell them rather than take the new issue if they could get it at a premium. Frequently in those periods we would offer as many as a billion dollars' worth of the maturing treasury issue before we got through.

Now, this policy was abandoned in 1953 and the treasury has priced its issues more attractively -- tended to price its issues more attractively -- and all the market is absorbed one way or the other, and when they are faced with a question of not being able to sell at a premium, frequently they don't sell, they turn issues in on exchange, so that the system hasn't been in a position of having to take over a lot of securities they don't want and have to sell something else to offset it.

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new offering, the system stepped in to purchase some of these securities or support the financing that was announced and the market was changing very fast. The idea at that time was that it would go out and buy some of the longer-term securities that were being offered. Actually, they ended up by buying the rights or the -- or on the "when issued" basis the short-term securities that we have offered. There were two batches being offered at the time of this announcement but very few of the long-term because people had been working on the short-term ones, and again we bought a billion dollars' worth in a few days. I don't think we ever sold those particular issues and probably still have them unless they have matured, but we had to put something else on the market to offset the effect on the reserves and that made the dealers a little sore, too, because those who had taken the new issue found themselves holding the bag and then the Federal Reserve was later trying to dispose of some other securities in order to avoid having a very large volume of excess reserves running around the market in a period of economic recovery when interest rates are sure to go up. So that the view is that to the extent possible the Federal Reserve stays out of the market and it is the obligation of the treasury to price its issues and make offerings that would be attractive on their own rates without Federal Reserve support. I don't know whether that tells enough of the story or not.

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connection with the timing; does this mean that the treasury consults with the Federal Reserve and they try to pick a time when the Federal Reserve can remain neutral as far as monetary policy is concerned?

MR. THOMAS: As to the treasury's financing date, there is not much choice about that, particularly on a refunding operation; they have to be done at the time of the maturity of an issue.

On new money financing they have sometimes a little choice, but frequently not very much because the treasury doesn't carry a very big balance ordinarily but to the extent to which there is a choice, yes, the treasury tries to time its financing so that it will not come at a time when the market is under pressures from other things and also to leave something available in case there might be a change in the policy procedure of the system.

There might be need for some change, and for that reason the treasury has tried to have its maturities arranged so they will not conflict in the market, because by the time they get through with one operation they have to start thinking about moving towards the next one, but by increasing the amount of bills outstanding, which are sold on a discount basis and doesn't require market support or nursing by arranging its maturities on other issues so that they mature about once a quarter, they have more leeway or more free time than we had at one time a few years ago when there was something maturing almost every

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month, either maturing or a need for cash.

COMMISSIONER BROWN: If you do come into an area of conflict of opinion between debt management and monetary policy, how is it resolved?

MR. THOMAS: I don't know that there would be a conflict of opinion between debt management and monetary policy; the treasury makes its own decisions as to what they think that [illegible] management ought to be and the treasury in making its decisions is likely to be and frequently is influenced by the state of liquidity of the economy as to whether they want to put out more short-term securities or more long-term securities, but mostly because of the structure of the debt, which is already over-balanced on the short side, they will tend to put out the long-term issue whenever they can get away with it and it is the state of the market that determines when these issues are put out.

Now, as for monetary policy, the ideal is that monetary policy goes on its way regardless of debt management and if the situation is such that there is a strong demand for credit, relative to the available supply, then the interest rates are permitted to adjust and also the monetary policy and the amount of supplies they think are appropriate for the money supply that is suitable under the circumstances, and the treasury is just one of the borrowers in the market and the treasury has to meet the market terms; that is the general philosophy.

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met the market terms and sold these issues outside the banking system, but it is not a function of monetary policy to see that the treasury can sell its securities under any terms it wants to sell them at any time; they have got to meet the market forces and adjust their rates to the realities of the situation.

I don't understand much about this conflict between debt management and monetary policy. I don't think there is necessarily a conflict. Monetary policy is determined by the monetary needs of the economy as a whole and the treasury has to adjust to it.

COMMISSIONER BROWN: Would you care to describe to us how the consulting committee on dealers operates?

MR. THOMAS: You mean with the treasury?

COMMISSIONER BROWN: Yes.

MR. THOMAS: Well, they have two consulting committees; one with the American Bankers' Association and one with the dealers, the so-called dealers' committee, and the investment bankers association is composed of representatives from the dealers and also representatives from the bond departments of the banks. Frequently the president of a bank will be meeting with the bankers' committee and his bond man will be meeting with the dealers' committee at the same time.

Now, they come into the treasury generally a few days before the treasury is going to make its announcement as to financing. Actually, what frequently happens is that they will come in on a Wednesday,

met the market terms and sold these issues outside the banking system, but it is not a function of monetary policy to see that the treasury can sell its securities under any terms it wants to sell them at any time; they have got to meet the market forces and adjust their rates to the realities of the situation.

I don't understand much about this conflict between debt management and monetary policy. I don't think there is necessarily a conflict. Monetary policy is determined by the monetary needs of the economy as a whole and the treasury has to adjust to it.

COMMISSIONER BROWN: Would you care to describe to us how the consulting committee on dealers operates?

MR. THOMAS: You mean with the treasury?

COMMISSIONER BROWN: Yes.

MR. THOMAS: Well, they have two consulting committees; one with the American Bankers' Association and one with the dealers, the so-called dealers' committee, and the investment bankers association is composed of representatives from the dealers and also representatives from the bond departments of the banks. Frequently the president of a bank will be meeting with the bankers' committee and his bond man will be meeting with the dealers' committee at the same time.

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the banking committee will meet with the treasury on Wednesday morning and go out and have lunch and come up with these recommendations in the afternoon, and then investment dealers will meet with the treasury Wednesday afternoon and the treasury presents to them a picture of what the debt problem, is how much money they may need, how long it may last them and what refunding operations there may be. Most of them know it generally already, but it gives them more specifically the treasury views as to what it thinks its problems are, and frequetly the secretary or the under-secretary will present that and say, "Are there any questions on which you would like to have answers?" or, "Shall we put out low, medium or short-term issues at this time?" and other features of the operation, or should it be on an issue if it is a refunding problem, should it be offered in exchange or offered on a cash issue and pay off the maturing one, various questions of that sort which will depend on what the attitude of the market is at the time and what seems to be coming before the market.

The committees will then meet by themselves and come to some recommendations and will present themselves to the treasury, and then at the same time the secretary may be asking the advice of a lot of other people, including the marketing committee and generally I think that the manager of the market accounts sits in with the treasurer in these discussions with the dealers and the chairman will be there, the chairman of the board will be there at various times,

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and finally the treasury staff gets away with the secretary and they make up their minds what they are going to issue. The chairman of the board might be there when the actual decision is being discussed or being made, and that is likely to be made around noon on Thursday, and they announce it Thursday afternoon and it appears in the Friday morning papers and the subscriptions come in on Monday. If it is a cash issue it is one day; if an exchange issue they are given three days.

THE CHAIRMAN: You mentioned the chairman of the Board. Which board?

MR. THOMAS: The Federal Reserve Board.

THE CHAIRMAN: The Federal Reserve Board?

MR. THOMAS: Yes.

THE CHAIRMAN: And the Federal Reserve Board is generally consulted?

MR. THOMAS: Yes, but the decision is made by the treasury.

THE CHAIRMAN: Yes, I understood that, but they do consult?

MR. THOMAS: Oh yes.

THE CHAIRMAN: On the maturities of the interest rates and other aspects?

MR. THOMAS: That is right. Now, currently the Chairman of the Board has lunch with the secretary of the treasury generally every Monday and any current questions that are coming up are likely to be discussed; the questions that are of mutual interest to the treasury and the board, and I imagine some others at

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times, and then every Wednesday the under-secretary of monetary affairs and the members of his staff -- three, four or five of them -- come and have lunch with the board's staff, at which the chairman and the vice-chairman of the board attend and the members of the board's staff engage primarily on the open market operations, and there would be advisors to the board. Primarily what happens is that the advisors to the board and the secretary of the market committee, who is now also head of the international finance division, and when these questions are put -- frequently they are on international questions more and more at this time -- the head of the international finance division would be there and the head of the division of research and statistics and the members of the staff that are engaged primarily in any mapping out of the government securities market, and so forth, and at this meeting the question of the treasury plans and problems -- and sometimes what the Federal Reserve problems are -- are discussed.

Of course, nobody makes any commitments as to what might be done at any meetings like that; this is only entirely a matter of opinion and discussion in an attempt to get a mutual understanding of the nature of the problems being faced, and frequently there is a lot of hot argument to express any differences that they have in order to arrive at a concensus with all possible considerations in mind.

Then, we have daily contacts with treasury. The treasury gets daily reports on the market situation

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directly from New York from the Federal Reserve Bank the same as we do and they are in daily contact with the New York bank and the market in connection with their handling of their cash balances, because they keep a minimum balance with the Federal Reserve and most of the treasury funds are kept out in the commercial banks under what we call our loan accounts, where the funds that come into the banks are credited to the account of the treasury and certain of the big banks charge us under subscriptions for new issues, and then the treasury calls upon these as they need the money, so they have to be in constant contact with the New York Reserve Bank and together they decide what the calls should be. Sometimes those calls are made with two or three days' advance notice to some of the big banks who are subject to call for payments on any day; the call may be around about 11 o'clock in the morning and if the treasury balance doesn't conform to the expectations -- that is, the treasury balance with the reserve banks doesn't come up to expectations -- they make a special call to these large banks.

If their treasury has a bigger balance than the need, they will frequently re-deposit in these large banks. That is because the treasury balance at the Federal Reserve affects the supply of reserves available in the market, and they try to keep it even at around $400 million or $500 million all the time. So there is constant contact between the treasury and the Federal Reserve on all these matters; free exchange of views; very few secrets. There is a lot in the foreign exchange field and the handling of the gold and bond balances.

THE CHAIRMAN: The Federal Reserve position in the consultations would be merely an informal one?

MR. THOMAS: Purely advisory.

THE CHAIRMAN: Their advice, if they tendered any advice, might be different from any advice given by the treasury officials?

MR. THOMAS: Frequently is.

THE CHAIRMAN: Except when it has the full responsibility of decisions.

MR. THOMAS: It might be different from the advice given by the dealers to the banks.

COMMISSIONER BROWN: You mentioned the tax and loan deposit accounts: Do all new issues qualify for these?

MR. THOMAS: Cash issues generally do, yes, unless the treasury's cash position is so tight they have to have the money right away. Weekly bill offerings do not because new bills are bid for and old bills have to be paid off, but occasionally the treasury

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will put out an issue of one year bills, longer-term bills, or a special issue of tax bills, and put off tax anticipation bills that mature within a week after corporate income tax dates, particularly in March and June, and those bills can be used by the corporations for payment of taxes. Those bills are generally issued at a time when the treasury is spending more money than it is receiving: In July and October particularly, December maybe, and sometimes January. They may be eligible, and generally are eligible, for payment through tax and loan account, but mostly any new issue for cash is likely to be eligible if the treasury does not need that money that promptly, particularly if it is a large issue. It is a sort of an underwriting device. The banks can subscribe and pay for it through tax and loan account. They get the interest on the securities, or they sell the securities if they want to, and then they don't have to pay until the funds are drawn which frequently will last as long as 25 or 30 days -- sometimes longer. So it gives them a little bit of an inducement, and in the meantime the banks will be pushing the securities out into the market if they don't want them themselves. It is a very useful underwriting arrangement.

COMMISSIONER BROWN: How do banks qualify to become a depositor? I notice that apparently non-member banks can deposit?

MR. THOMAS: Yes. I am not sure I can give you the details on that. They have to be of certain

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size, but I think most any bank can qualify except, of course, the very small ones which would not want to undertake the responsibility of subscribing for the minimum amounts. They are divided into three classes: A banks. B banks and C banks. The A banks are the smallest, and the B banks are the medium-sized, and the C banks are the banks with total deposits of over half a billion, and they are the ones that are subject to a daily call. As far as the others are concerned, the call is always at least three days in advance. The A banks are called on maybe much less frequently; the small banks are called on much less frequently than the medium-sized banks.

COMMISSIONER BROWN: How is the operation of debt management on outstanding issues co-ordinated with what the Federal Reserve might be doing? As I understand it, that is all done through the Federal Reserve?

MR. THOMAS: You mean the exchanges of maturing issues?

COMMISSIONER BROWN: No, to the extent that debt management or other government agencies are operating in the market for the longer issues.

MR. THOMAS: You mean purchasing of securities for government accounts, treasury accounts, agency accounts?

COMMISSIONER BROWN: Yes.

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On the other hand, there are times when the tresury, like any other investor, would say, "We think this security is out of line and we will do some shifting, in our judgment. We can better our position

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by shifting out of one security into another."

COMMISSIONER BROWN: We have heard complaints in the Canadian market that the dealers frequently don't know whether the Bank of Canada is acting as agent for a government account or principal, and they have the attitude they should always know when they are acting as an agent.

MR. THOMAS: You can't blame them for trying.

COMMISSIONER BROWN: The Bank of Canada has had the attitude they would like to tell them at all times. I was wondering if you could tell us what the reaction among the New York dealers would be?

MR. THOMAS: Oh yes, they like to know everything. One dealer has a bell in the room, and when there is an indication that the Federal Reserve is in the market this bell rings so that the traders will know what is going on.

COMMISSIONER BROWN: Do they have two bells -- one for buying and one for selling?

MR. THOMAS: Or a light shows, or something like that. It is their business to trade and any information they can get is all to their advantage.

COMMISSIONER BROWN: In your paper you said ---

MR. THOMAS: But I may say on this point, of course, that the Federal Reserve has always endeavoured to make as much information as it reasonably can available to the market and to the public. We operate on the principle that the more the public knows the

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COMMISSIONER GIBSON: You don't see any reason why you should inform them whether you are trading on your own account or on account of the treasury if it is to your advantage not to?

MR. THOMAS: Yes, because we generally like not to tell them everything.

COMMISSIONER BROWN: You mentioned the Federal Reserve Act prohibits the Federal Reserve from lending directly to or buying securities from the treasury and then you say, "except to a limited extent".

MR. THOMAS: Yes.

COMMISSIONER BROWN: What is the limited extent?

MR. THOMAS: There is an act which is re-passed every two years which permits the Federal Reserve to buy up to $5 billion of securities directly from the treasury. This prohibition against the Federal Reserve buying from the treasury, I think, was put in by Senator Glass in the early 30's -- the Banking Act of 1933. Then there was, however, the exception which was designed originally -- designed primarily, let us say, to permit the treasury to borrow

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from the Federal Reserve if at any time its balance gets so low and receipts don't come in according to expectations, or expenditures go out faster, or if at any time the treasury expects very large receipts, as it does on tax dates, in a few days and it doesn't want to draw money out of the market to meet current payments and a few days later have a great big increase in its balance. It will just borrow from the Federal Reserve for those few days rather than put that amount of pressure on the market: What we call borrowing under the special certificate. That has at times amounted to a billion or two dollars; it has never gotten up to 5 billion. In recent years it has seldom been used, particularly since they adopted this provision of special calls on C banks that makes it possible for the treasury to balance its cash inflow more closely than it could when it had to make the calls several days in advance and never could make re-deposits. Since that has been done there has been no occasion to use this provision.

Also, always one of the arguments for it is that it is there in case of an emergency. If you have an outbreak of war, or a run on banks, or this that and the other, and the treasury has to put out a lot of money, or the market goes to pieces and you can't float an issue within the time limit that is permitted, it is there for that sort of use; but it is definitely understood that it will be used only on an emergency.

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COMMISSIONER BROWN: Mr. Chairman, I had some

other questions about the techniques of monetary policy, but perhaps some of the other Commissioners have questions on the debt management.

In paragraph 57 you refer to the three well known instruments of monetary management: Discount operations, purchases and sales of securities and bills in the open market, and changes in reserve requirements. I was wondering if you would care to comment on the relative appropriateness of these three different operations particularly with reference to the fragmented banking system of the United States, and possibly, if you would care to, in relation to the different type of banking system in Canada?

MR. THOMAS: I think there may be different requirements in those conditions. Certainly in our fragmented or atomized banking system the need for reserve adjustments and the need for liquidity to meet reserve losses, I would presume, would be much greater than in a system of very large branch banks covering the whole wide areas of the country, because so many shifts of funds that take place as between banks would be absorbed within the large branch banks. So that, you would not have the necessity for as many reserve adjustments, or with some banks being short of reserves while others had excess, and also with so many of the banks not having very quick access to money markets I think it is highly desirable that they do have ability to borrow from the Federal Reserve whenever they think it is necessary. Since the development of the treasury bill market the access

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to money markets is a little quicker, and even before that the country banks, the small banks, made a lot of their adjustments through the system of inner bank balances with which they had correspondence in the cities. They could do that through the telegraphic system or through letters and call on the banks on their correspondence for shifting funds from one bank to another, shifting them over to the Federal Reserve.

So that a lot of the adjustments were made through that process, but the city banks, of course, can never know what demands are going to be made on them by their correspondents and to some extent the same thing is true with many correspondents; they may shift their balance back and forth. I suppose to some extent they feel obligated to let the bank know if it is going to be any big shift, but our banks are subject to a very wide day to day variation in their reserves which I would think would be greater than your banks would have.

Also, we, I think, are probably a little stricter on maintaining reserves up to a point. We do it on a weekly basis and the reports come in very promptly so that the banks have to be very careful about not getting too far out of line in their reserve position in any one day because they have to make it up in another. And then some of the big banks and maybe some of the smaller ones too do some very sharp figuring in trying to avoid having any idle funds around, and if they have any excess they will try to put it to use very quickly either for buying bills or lending it to another bank and it will sometimes end up that we will find that inadvertently they are short of reserves and have to borrow the last day.

But we have a lot more access to the discount window for all those reasons than I should think you would be likely to have in Canada. We try to see that the discount window is always open and anybody

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[illegible] city banks, of course, can [illegible] know what demands are going to be made on them by their correspondents and to some extent the same thing is true with many correspondents; they may shift their balance back and forth. I suppose to some extent they feel obligated to let the bank know if it is going to be any big shift, but our banks are subject to a very wide day to day variation in their reserves which I would think would be greater [illegible]

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But we have a lot more access to the discount window for all those reasons than I should think you would be likely to have in Canada. We try to [illegible] window is always open and anybody

can come and borrow, but it is a window and not a door; they are not supposed to go and stay.

COMMISSIONER BROWN: Just look in?

MR. THOMAS: Yes. They are not supposed to live there. And so, when any bank borrows continuously then there is some administrative checking up on its position and an encouragement to make the adjustments that will take them out of the window.

COMMISSIONER MACKINTOSH: What would you consider an overdue stay?

MR. THOMAS: Well, it is a little difficult because these things are done on a weekly average basis. You cannot say continuous. A bank can borrow on the first day of a statement week or the last day of a statement week and get out the next. So it would have to be borrowing every week for a period of -- I do not know, in collecting statistics on it what we do is to have a record of the banks that have borrowed so many weeks out of the past 13, those who have borrowed every week out of the past 13 and those who have borrowed a majority of the weeks, and others who have not borrowed at all. The majority of banks never borrow at all. There are just a few that really borrow but there are some who are fairly continuous and frequent borrowers so it is figured out on that basis. It depends on the individual situation.

There are some banks that are really in trouble and have to borrow. Some banks will deliberately get themselves in trouble so they can borrow, but that

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There are some banks that are really in trouble and have to borrow. Some banks will deliberately get themselves in trouble so they can borrow, but that

is one of the matters of administration that the reserve banks are responsible for and that varies, of course, depending on what the general volume of borrowing is. So that is the way the discount window is operated.

Now, the open market operations are designed to supply the reserves in a way that would make it unnecessary for banks to borrow or to relieve them of the necessity. There is no way of knowing that the open market operations will necessarily result in reserves going to the banks that are already borrowing except that we know when we do have heavy open market purchases and banks are borrowing, those borrowings get reduced awfully fast. There is a very quick response and also the reserves will go to the banks and very few banks will hold excess reserves. There are a few country banks that consistently hold excess balances at the central bank just as they hold reserves at correspondent banks. It is a form of secondary liquidity reserves, they think. But generally that is a fairly steady amount. Most other banks do not hold excess reserves so that whenever the system buys securities it has an immediate effect upon the reserve picture and has an awfully quick reflection on the volume of credit. The banks put their money to use very fast by one device or another.

Now, changes in reserve requirements is a much more awkward device because it certainly affects all banks all over the country and involves a whole lot of adjustment. It is very difficult to ever have

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an increase in reserve requirements without having a very marked effect on the money market unless it is a situation where there are redundant reserves pretty well scattered around and all you are doing is absorbing those, but even in 1937 when we raised reserve requirements a lot and banks had a good deal of excess requirements before and quite a lot after that, it still did have repercussions because some banks had to meet bank reserves and did not have excess reserves to cover. So I think it is a device that has been very difficult to use except in the case of a very fundamental adjustment in the level of reserves.

We have used it at times to make reserves available at a time when you have to make quite a lot, or want to make quite a lot. It was done in 1954 and 1958 during the recession when we wanted to put out reserves and when reserve requirements are reduced in city banks the response is very fast. It is a little slower for country banks.

Sometimes we might, in a period when you think you want to put out a lot of reserves but do not want to do it in a way that will have a lot of excess reserves running around, you might reduce such reserve requirements, say, in December, at the time of the Christmas currency need and then absorb it by selling government securities.

Some of the congress men do not like that because they say this is just one way of increasing bank earnings instead of having the Federal Reserve

getthe earnings and then it will go back to the treasury. Of course, on that basis you can finance the whole government debt by printing money. It is just the question of where you draw the line. But in a situation, say, as we had in 1959 and 1960, where we had a large gold outgo, that reduced the bank earnings excess and some reduction in reserve requirements might have gone a long way towards meeting that. There is a feeling that commercial banks are rather on the high side. It used to be 7, 12 and 13 for the three classes of banks for demand deposits. They are now 12 and 16½ for two classes and you can operate a banking system with a lower level of requirements and there may be a tendency to gradually lower the rates and narrow the range between the two classes. There is a point of view to that effect, that that may be desirable. But it is used primarily for rather major shifts of a structural nature rather than to take care of this variation in reserve needs. I do not know whether that covers all your points.

COMMISSIONER BROWN: I think so, although I think we will probably have some questions within each one. For instance, on the discount rate, is this pretty well changed all over the country at once now?

MR. THOMAS: Yes.

COMMISSIONER BROWN: Do you give a signal or does it follow the event?

MR. THOMAS: It generally, I would say, follows

the event. The discount rate cannot get too far away from the bill rate. It cannot be kept too far below the bill rate because then the banks will be encouraged to borrow and hold on to their bills and if it is desirable to supply banks with reserves then the system should do it through open market operations and not force them to borrow.

If the bill rate is above the discount rate the banks would borrow and increase the supply of reserves and then that would put the market under some pressure. It would also tend to bring the bill rate down a little bit and increase the supply of the reserves but the difference there would be one of the balancing of forces. The borrowing is in a sense a tightening device that offsets to some extent the effect of the additional reserves that are put out. So actually the bill rate seldom gets very far above the discount rate for that reason; the banks will borrow and then sell their bills.

Theoretically, the bill rate might get away below the discount rate if banks had abundant reserves and were not under any pressure to borrow. In fact, even under those conditions there are always some banks who would have to make reserve adjustments from week to week and from time to time and if you get a bill rate that is far removed from the discount rate you are likely to get an erratic bill market on purely temporary grounds.

Take last year, the bill rate got down to $2\frac{1}{4}$, the discount rate was kept at 3 per cent. When you

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Take last year, the bill rate got down to $2\frac{1}{4}$, the discount rate was kept at 3 per cent. When you

would run into a period of temporary reserve needs around tax time, the bill rate would tend to shoot away up and then tend to come down. I would be inclined to draw the conclusion on that basis that probably the holding of the discount rate at 3 per cent was probably one of the factors that actually kept the bill rate from going down any more than it did because even though we were not -- I mean, you are in a period of slack there and we were following the policy of not letting rate come down, but I thought the holding of the discount rate was one of the factors that kept the bill rate from coming down as much as it did in earlier periods.

Of course we had about the same volume of excess reserves running around and about the same level of borrowing and no great credit demand. If we had reduced the discount rate, the bill rate probably would have gone lower so you have to keep the discount rate somewhere near the same level that the bill rate is and generally what happens is that the pressures on the market will cause the bill rate to move up or down prior to a discount rate change.

One time it was used as a signal, say, in November 1957. There was a change in the economic situation which was not evident in the statistics. The policy had been a policy of restraint and it changed again, occurring around September. We had no figures that could prove it until really about the end of October or early November and money market rates were still up. There was a little indication in the credit

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situation, a flattening in the demand for loans and we began to detect that and decided in the middle of November at an open market committee meeting that the discount rate ought to be lowered. It was about the time that the treasury financing operation was to be announced and the delicate question arose as to whether it should hold off making this change in the discount rate until after the treasury financing or do it before and it was decided it would be fairer to the market in general to get it done and there were very quick meetings of boards of directors and telephone calls and the thing was all done within about 24 or 48 hour period after the analysis indicated that it would be desirable and the announcement was made immediately in order to get it done before the treasury financing announcement.

COMMISSIONER MACKINTOSH: There is no attempt then to hold the discount rate uniformly at the penalty rate?

MR. THOMAS: Oh yes, it has to be a penalty rate. To some extent it is always a penalty rate.

COMMISSIONER MACKINTOSH: If it is below the bill rate?

MR. THOMAS: If it is below the bill rate -- well, the bill rate does not stay up very much. It stays within a one-quarter per cent range generally and the banks sometimes will borrow rather than sell bills if they think the borrowing is for purely

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temporary purposes because if they sell bills in a tight market and then have to buy back in an easy market they will have to pay more for the bills than they got so they will borrow for a few days to adjust their positions, but it is still something of a penalty. They still do that sometimes when the bill rate is below the discount rate.

They will borrow rather than sell bills. If the bill rate is above the discount rate they will tend to sell bills rather than borrow but even so borrowing is always in a sense a penalty. They do not like to borrow.

THE CHAIRMAN: We will adjourn for ten minutes.

(At this point a short recess was taken.)

THE CHAIRMAN: We shall proceed.

COMMISSIONER BROWN: Mr. Thomas, I wonder if we might retrace our steps a little bit. There was a question I omitted to ask in connection with debt management.

As we understand the situation, one of the results, or at least one of the things that does happen in the distribution of the Federal debt, and a good part of this may arise because of the way the debt, or distribution in Canada with dealer incentives to make retail sales is handled, is the accomplishment of a larger proportion of our Federal debt in the hands of individuals. Therefore, a relatively wider distribution occurs than would occur if it were only in institutional hands. I wonder if you would care to comment as to whether this might be correct or not and also on the assumption that it is correct, what implications it has in respect of monetary policy?

MR. THOMAS: Well, I had not been aware that you had a larger proportion of your debt in the hands of individuals than we have, so I had not thought through the reasons why that might be the case. It might be because your individual investors do not have other means of investing. Is that true of the marketable debt other than savings bonds?

COMMISSIONER BROWN: Yes.

MR. THOMAS: You are not including savings bonds. You have had a very good distribution of your savings bonds too, I think.

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COMMISSIONER BROWN: That is right.

MR. THOMAS: That is from the standpoint of the treasury, because they have sold quite a lot.

I do not know how I could explain that from the standpoint of general economic policy, let us say. Of course, one of the aims of such a debt management and monetary policy is to encourage as much public holding as possible of the debt instruments. A lot of ours goes out through institutions; banks that have time deposits, and they may hold government securities as against this saving in time deposits. I do not know, I would have to analyze the relationships to know what is the significance of the different distribution.

COMMISSIONER MACKINTOSH: Our dealers modestly explain that it is the result of their superior selling efforts.

MR. THOMAS: Maybe that is what it is.

COMMISSIONER BROWN: I bow and say thank you at this point.

MR. THOMAS: You operate through more regular security dealers than we do. Our dealers in government securities are few, who in turn operate through the banks and other security dealers all around the country. In floating your debt you sell them to dealers in general. I do not know whether that should make much more difference. Our banks buy them on the tax and loan account basis, so it gives them a little profit. Frequently if they do not want to hold them they can sell at less than they

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paid for them and still make a profit. I refer to the issues of tax bills, for example. They borrow on the tax and loan account. Nobody other than the bank would subscribe to these because the banks will pay a higher price for them than a dealer could afford to pay, for example, because the banks get the exemption of the tax and loan account provision for a few days and they may turn right around and sell them the next day at less than they paid for them and still have a net profit on the operation, or a net return on the operation, maybe it is more correct to say. That is still the process of distribution. I think in the final analysis as to whether government securities are held by the public or by individuals rather than by institutions would depend on the availability of other types of investments for individuals in the relative volume of saving in the country. It may be that the dealers do a better selling job on them.

COMMISSIONER BROWN: Well, thank you very much.

COMMISSIONER LEMAN: For one thing, Mr. Thomas, I think we discovered last week by talking to some of the witnesses before us that so far as it can be measured, and this is not an accurate measurement, a slightly higher proportion of total savings in the United States are in institutions than in Canada.

MR. THOMAS: That is what I was wondering, if that would not be true. So it is institutions that do invest in government securities or mortgages rather

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than individuals.

COMMISSIONER MACKINTOSH: Would it be safe to infer that institutions are more market conscious than individuals?

MR. THOMAS: Oh, yes, I think so, yes. They hire vice-presidents and pay them big salaries to do this.

COMMISSIONER BROWN: To get back to the question of the discount rate, do the purchase and re-sell accounts or agreements take place just in New York also and are these related to the discount rate?

MR. THOMAS: I am glad you brought that up because I failed to cover that.

The purchase and re-sale agreements are made only with dealers; non-bank dealers in government securities, so they are only made, or likely to be made only in New York, although other reserve banks have the authority to make them. I think some have been made in Chicago, but it is most likely that the dealers will do this in the central money market where all the buying and selling is concentrated. They are more likely to do it that way. This does not mean that the money all stays in New York, because this really represents the purchases that dealers have made in securities all over the country, and the actual bills or securities that are put up may be put in another reserve bank. That would be effected through the wire transfer system.

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agreements; open market operations and discount, I think it would be correct to say that re-purchase agreements have something of the nature in each. We count them as being open market operations, but actually they are temporary loans to dealers; very temporary. They are paid off rather quickly. They are generally made at a little higher rate. Perhaps not a higher rate than the dealer could have got on them, but a higher rate than is likely to persist, so the dealers will take up the re-sale contracts as fast as they can and pay them off rather promptly. So that it is in the nature of a temporary accommodation that is likely to keep the market under some pressure. It is not as easing as outright purchases.

COMMISSIONER LEMAN: Is it at a negotiated rate, do I gather?

MR. THOMAS: No, it is not a negotiated rate. The account manager has the authority to set the rate. It cannot be above the discount rate and it can be as low as -- I forget -- one-eighth or one-quarter below the last option rate on the latest issue of 90-day bills. I would have to check the exact wording of that in the policy record which is published in the annual report. Generally it is all done at the discount rate, but in a given situation where you want to put reserves out for a few days and do it quickly, the manager may actually make them available below the discount rate. Generally dealers can borrow below the discount rate. They can borrow

from the market and from the Federal Reserve. They can borrow from banks or elsewhere on the market below the discount rate, and generally below the bill rate. Sometimes there are temporary stringencies and they have to come to the Federal Reserve, and whether it is done at the discount rate or a lower rate is a decision for the account manager. Whatever is done it is the same rate for all dealers as of that date.

COMMISSIONER LEMAN: Is there a special dealer list which is available?

MR. THOMAS: There is a dealer list. It is a list of dealers within the system who will enter into transactions. We used to have a list of so-called approved dealers. We did away with that because it sounded like the giving of special favours to some particular dealers. Now they will operate with any dealer who is prepared to make markets on his own in government securities. They will not operate with a dealer who is just a middleman, but if he is prepared to make markets and buy government securities on his own, and generally he also is expected to participate in the option for treasury bills, then the system will deal with any dealer who has given evidence that he does those things. Also he has to have evidence that he has a capital basis that will give assurance that he can live up to any contract that he enters into.

COMMISSIONER LEMAN: You mentioned trading Federal funds. What is the machinery for this?

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COMMISSIONER LEMAN: You mentioned trading Federal Funds. What is the machinery for this?

MR. THOMAS: There are various types of operations for that. A large part of the trading in federal funds, which are in balances at the reserve bank is simply done by one bank obtaining from the other an immediate transfer as of that date, off the books of the Federal Reserve in exchange for a cheque which is cleared through the clearing house the next day. A very large part of the operations are done on that basis.

Government security dealers also trade in Federal funds although they probably have to put up at times some collateral, or they may enter into re-purchase agreements on a Federal fund basis, or the dealer may borrow from a bank, either on a Federal fund basis or on a regular delivery basis. Some banks will not lend to dealers on a cash one day basis. They will lend, but the money is not available until the next day. Some will lend on a minimum credit basis. There is a great variety of transactions that can meet the definition of Federal funds. Basically it is an immediate exchange on an immediate basis of a balance with the Federal Reserve, and that will be repaid either the next day or within a very short period of time; mostly the next day. It is a sort of day loan.

COMMISSIONER GIBSON: Do you see any objection to the marketing of Federal funds from a central bank point of view?

MR. THOMAS: Well, this again is sort of a personal view because there is some feeling in some parts of the system that this is sort of getting around

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MR. THOMAS: Well, this again is sort of a personal view because there is some feeling in some parts of the system that this is sort of getting around

the Federal Reserve. It is a way of getting Federal Reserve credit without having the discipline of coming to the Federal Reserve.

My own view is that I look at it the other way. It is a device for making use of Federal Reserve funds that are already available in the market. If those funds were not obtained by the banks that needed them, the banks that needed them would be coming to the Federal Reserve and borrowing. We would actually have more credit and more reserves outstanding, and the banks that had the excess would be under pressure to pay them. Whereas, if they could sell them to another bank that needs them temporarily they actually reduce the amount of Federal Reserve credit that is available. At least that is the way I would analyse it.

There are others who think that sometimes it is a way of getting away from the discipline of the Federal Reserve and the discount window. If the banks could not get the Federal funds they would have to come in and be subject to more restraint.

COMMISSIONER GIBSON: Do you particularly want to see them when they need Federal funds?

MR. THOMAS: We get reports every day from all Federal fund transactions from all of our banks, and any action using the discount window is taken into consideration.

COMMISSIONER GIBSON: There is one thing I would like to clear up in respect of the discount window.

You told us that you had an analysis of the number of times the banks came to the discount window each week, and you said in a 13 week period there would be some who would come in every week, some four or five weeks, and some would not come at all. Now, you did not make it quite clear, but you did take a mildly dim view of it. The banks that come in every week in a 13 week period; that is a phenomenon with which you are not very happy?

MR. THOMAS: Yes. That bank is using Federal Reserve credit. The bank is borrowing in order to increase its lending capacity. If the bank borrows Federal Reserve credit it is putting additional reserve credit in the market, and that may be more than the Federal Reserve wants to supply. It is very important that borrowing be restrictive. Otherwise, if banks come in and feel free to borrow at any time in any amount you would have great difficulty in keeping the supply of reserves under control.

COMMISSIONER GIBSON: You do not feel the rate is a sufficient penalty to keep them away?

MR. THOMAS: No, it is not always a sufficient penalty.

COMMISSIONER MACKINTOSH: What do you do to discourage it?

MR. THOMAS: Well, that varies in the different Federal Reserve banks. The Federal Reserve Banks have a great deal of administrative freedom in that regard as to how they discourage it. They will either raise their eyebrows to the man who runs the money desk,

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or the president of the bank or the chief officer is invited to come in and have a talk with the president of the Reserve Bank or loans officer and analyse the situation to see what that bank is doing in the way of lending; how it is using these funds and what its portfolio is. It is a pretty careful analysis of the bank's position. They find out where this borrowing goes, and find out if the bank is really in difficulty and cannot get out of it.

Of course, the bank manager will sometimes say: Do you want me to sell government securities? Are you trying to force me to sell government securities? I think the answer generally is: "We do not tell you how to make this adjustment, that is your decision". There are various ways of doing this. After this practice was started, one bank used to borrow quite frequently and probably for justifiable reasons, and the manager then said: "I am not going to subject my-self to this. I will never borrow".

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COMMISSIONER MACKINTOSH: This may be professionally a kind of off-key note, but everything else is the market.

MR. THOMAS: Yes.

COMMISSIONER MACKINTOSH: There is no moral suasion, no attempt to preach at them; you put your transactions through the market and await the market reactions, but here you say that the discount rate may be even a little below the bill rate but that the best people will not take advantage of that.

MR. THOMAS: Well, that is ---

COMMISSIONER MACKINTOSH: There is almost an English accent in your voice!

MR. THOMAS: Yes, that is the difficulty that arises when you deal with thousands of individual banks; you are always going to find somebody who will take advantage of a privilege, an undue advantage, and then you have to remind them of the conventions.

COMMISSIONER MACKINTOSH: What is the reason why it could not be a shade above the bill rate?

MR. THOMAS: Well, it is not always the bill rate; some banks might borrow in order to extend credit.

COMMISSIONER MACKINTOSH: Oh, I see.

MR. THOMAS: You see, there is such a great variety of rates and any bank might find it profitable to borrow it at a discount rate and loan -- the bill rate is the more important because by convention -- it is mostly through bills that banks do

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adjust their reserves; if they want reserves they can always have bills, but actually the bill rate is a more accurate reflector of the degree of pressure that the banks are under at any one time, and that is the instrument which they are most likely to use or it is the instrument that is more closely related to the assessment rate, but actually, if an individual bank wants to go in and borrow and make loans and mortgages, or consumer credit or farmers or what not, he can always find some way of showing that it is a profitable operation and you will have to have a very high discount rate to discourage all that sort of thing; whereas it is much better to let them think that they have the privilege for use in a temporary adjustment, but to encourage them not to use it.

COMMISSIONER GIBSON: But is there not a maximum amount which any bank can borrow?

MR. THOMAS: No.

COMMISSIONER GIBSON: Is it a matter of discussion on each occasion?

MR. THOMAS: The general rule is that the bank can borrow any money it wants to borrow but if it persists in it then there is some discussion. Nowadays it would be very rare for any Reserve Bank to refuse or even question a bank's request to borrow at the time it makes a request. Later it might; later it might say that you have to get out of debt.

COMMISSIONER BROWN: What collateral do you have?

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COMMISSIONER BROWN: What collateral do you have?

MR. THOMAS: Practically all of the borrowing nowadays is on a note which matures within 15 days and is secured by short term government securities. That is the most convenient way of borrowing, and most banks keep short term government securities in safe keeping, and we mean in safe-keeping in a Reserve Bank, and it could be supplied within a matter of minutes or hours. Of course, they have the right of borrowing on any so-called eligible paper which, according to the Federal Reserve Act, when we have treasury bills or short term government securities it was a 90-day commercial paper, or you could have a six to nine month agricultural paper.

Now, they could go and re-discount that paper if they wanted to or use it as collateral for a single note, but for convenience and ease of operating it gradually moved more into the -- I mean, they did move more into the borrowing with the government securities with collateral. Even in the 1920's most of the borrowing, even when it was based on eligible paper, wason one note with a bunch of eligible paper as collateral, rather than a direct re-discount of the paper.

COMMISSIONER BROWN: You mentioned a 15-day note; can they borrow for 13 days or one day?

MR. THOMAS: They usually borrow -- I am not sure whether the note is actually written for 15 days or one day; it could be written for anything less than the 15 days, but they generally pay it off as quickly as they can get the money to do it. If

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they do it for one day they will come in and renew it. I suspect that a good bit of it is on a one-day basis.

COMMISSIONER BROWN: This may be kind of a side issue, but they try to avoid borrowing over a weekend?

MR. THOMAS: Well, the reserve period ends on Wednesday, and if they come into Friday with a big deficit, that deficit is carried over in his average for three days, so that they may rather borrow on Friday in order to avoid having this effect of an average for the week, but a good bit of the borrowing is made as of Wednesday and may be in rather large amounts to cover the deficit that has accumulated, but if they have a deficit at the beginning of the week they may borrow on Thursday and be sure and pay it off on Friday so it will not carry over the weekend, but they have it at the beginning of the week and if they think they will need it they will borrow, but if they think there is a chance they may adjust their position before the week is over, they will wait and borrow at the end of the week.

COMMISSIONER BROWN: Does the surplus also get averaged for the weekend?

MR. THOMAS: Yes, what they do is to -- you have the reserve balance every day and that is averaged, and then you average their deposits and the deposit position. The deposit position is at the opening of business and the reserve balance is at the close of business, so they do have one day's

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notice there on what they are operating on the reserve positions and they know what they have during the day, so the deposits as of the close of business from Wednesday to Tuesday, or at the beginning of business on Thursday to Wednesday are averaged, and the reserve requirements are figured on that basis and their reserve balance as of the close of business from Thursday to Wednesday is averaged and balanced off against it. Also, in addition to the reserve balance, you also count the cash in the vault and this is figured as the opening of business; that is something they know they have got at the opening of business.

COMMISSIONER BROWN: Would you care to comment on the question of a direct linkage between the discount rate and the bill rate?

MR. THOMAS: A direct linkage?

COMMISSIONER BROWN: Somewhat the system which we have in Canada.

MR. THOMAS: You mean the automatic variation in the discount rate? Well, there are people who think it would be useful to have that sort of system. My view -- and I think this is probably the prevailing view at present, at any rate -- is that we would rather have the discount rate fixed, probably, because there are times when we do not mind banks borrowing; we would rather have them borrow and adjust a temporary situation than to have the pressure come back on the market. If the discount rate is always above the bill rate, they would tend to be selling bills through it all during a period of

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temporary pressures, and we would rather have them borrow for those few days and take care of that -- because we know it is purely temporary -- than to have that pressure coming on to the bill market. I think that is briefly the answer, and sometimes you may not want to let the discount rate go down.

In the last year, for example, we were trying to keep the bill rate up and it is more convenient to have a discount rate fixed than to have it run, and this bill rate went down for purely practical reasons and we also have some temporary variations in our bill rate, but I think it is better to have the discount rate fixed.

Of course, there is the other argument that impresses some people and I think it should not be ignored and that is the signal effect of discount rate change. This is used as a definite indication of a shift in policy, you might say, or a shift in the situation, the recognition of a shift in the situation.

COMMISSIONER LEMAN: In connection with that, Mr. Thomas, someone made the suggestion some time ago that you could still have the benefit of the signal effect by changing that spread.

MR. THOMAS: Yes, that has been suggested, but I do not know; it seems to me you can get it more simply by just fixing the rate where you want it, but that is just a matter of slight preference and I would not try to argue too strongly one way or the other.

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COMMISSIONER LEMAN: In talking about signals, despite the fact that you do not seem to approve much of persuasion -- or moral suasion -- is it true to say that the Federal Reserve in the States use what is called an open mouth policy of explaining pretty well what its thoughts are about the general situation and does this constantly, or doesn't it?

MR. THOMAS: Well, I think it is true that the Federal Reserve endeavours to give the public as much information as it can about what it does and why.

Now, by that I think I said to you privately that anyone who is familiar with what the principles are under which the Federal Reserve operates and is familiar with the economic situation, ought to be able to know what Federal Reserve policy is or is likely to be, because the standards are reasonably definite and the system policy is adjusted as nearly as possible to the economic situation, and again there is also this tendency on the part of the market and the public to attribute any change in interest rates or in the degree of stringency in the money market to Federal Reserve policy and it may be due to changes in the market forces. I think that the importance of policy and policy changes is not to over-emphasize it as market values.

COMMISSIONER LEMAN: This stand you take on it worries me a little bit because of the fact that people who are in the business, in the financial business,

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MR. THOMAS: No, it is more based on the information that is subteley available as to the state of the economy. The Federal Reserve does not have much information that the public in general does not have. We get a little quicker information about the variations in reserves; we get this every day and the public does not have that, and we get a little more information maybe about what the treasury is going to do, but most people can figure that out about as well, and sometimes the information which we have may be misleading rather than accurate. These attempts to look on day to day fluctuations, sometimes, can mislead you, so that as a general proposition I would think that the whole effect of changes in Federal Reserve policy is over-emphasized. That is one reason for doing away with supporting the government securities market; the dealer has got more interest in knowing what the Federal Reserve is going to do about the market than they were in determining what the real market forces were.

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COMMISSIONER LEMAN: And that creates problems for the Federal Reserve?

MR. THOMAS: Exactly, not to mention the dealers and the economy as a whole.

COMMISSIONER BROWN: The suggestion has been made that if everybody had the same information and became of the same opinion, there would not be a market.

MR. THOMAS: It is the differences of views that make the market, but those differences should not necessarily be about what the Federal Reserve policy is going to be, but differences of appraisal of the forces of the market, and people ought to be able to do that as well as the Federal Reserve.

COMMISSIONER BROWN: Now, in the open market operations which were discussed -- which were touched on in connection with debt management -- you went into some detail on the daily discussions that took place between the Federal Reserve board in Washington and the market in New York. What sort of operating authority is given to the New York market?

MR. THOMAS: To the manager of the account in New York? That is an awfully good question and not a very easy one to answer. I have a copy of the formal directive here which gives the broad operating principles under which he is supposed to run for the next three weeks, and frequently that does not change very much; it is not changed every three weeks, sometimes there are small changes but in general he draws his conclusions from the discussions as to -- it goes around as to exactly how he should operate and

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he has to adjust to the pressures that develop in the market and there is a tendency sometimes to say, "Well, you will get about the same level of free reserves to excess reserves and minus borrowing at the banks", which indicates this is a measure of a degree of ease or tightness that is occurring in the market. It is not a bad guide for day to day operations, but it is not a satisfactory guide for long term operations because if you get a situation where there is a vigorous credit expansion and a reserve increase at a pretty fast rate and you keep a given volume of free reserves, then you will keep feeding reserves in response to the demand.

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On the other hand, if there is a credit contraction that is bigger than you think is desirable, and the banks pay off their borrowings and build up excess reserves, and you absorb this excess, you are encouraging a continuation of the contractive forces. So, as a longer run guide free reserves is not a very good guide or market manager. It may be a useful indication to the public itself as to the degree of tightness or ease that is being maintained. But even then it is subject to wide fluctuations because of temporary forces that you don't know about until after the event, because we don't know what the free reserves are as of any day and to the next day, and even some of those elements are estimated: The volume of required reserves we don't know until a couple of weeks later, although we do get daily reports from the big banks that give us a basis for pretty good estimating.

Another guide would be, what is the level of required reserves, which is another way of saying, what is the level of money supply or the volume of deposits. So, you maintain a given volume of total reserves that would make allowance for the fluctuations you expect to occur and keep a given volume of reserves. That is theoretically a good guide, but if the banks borrow to obtain those reserves then that is one degree of restraint. If they get them without borrowing, there is another degree of restraint. So, you have to take into consideration where the reserves came from. So, there isn't any single satisfactory day-to-day

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guide. You can look at the market behaviour sometimes, and the performance of the market itself would give an indication of a build-up of pressures. You don't know whether those pressures are building up because there is a stronger credit demand, or something is drawing away reserves temporarily, or there is a poor distribution of reserves in some banks and not in others.

So, he has to just watch all these forces and try to maintain a volume of reserves that is close to the level that is considered desirable as he possibly can at any period. Therefore, you try to avoid giving him a very specific figure. He has to use a certain amount of judgment, operating within the broad directives.

COMMISSIONER MACKINTOSH: Is he ever given a direction as to the level of interest rates?

MR. THOMAS: Yes, at some times he is given that, such as the indication to keep the bill rate from falling much -- in fact, that has been a directive in the past year and a half: Keep the bill rate from declining. I think this directive that I had in here has a little interest rate factor in it. Paragraph 75 at the bottom of page 30 of my version:

"To implement this policy, operations for the System Open Market Account shall be conducted with a view to providing reserves for bank credit and monetary expansion(with allowance for the wide seasonal movements customary at this time

guide. You can look at the market behaviour sometimes, and the performance of the market itself would give an indication of a build-up of pressures. You don't know whether those pressures are building up because there is a stronger credit demand, or something is drawing away reserves temporarily, or there is a poor distribution of reserves in some banks and not in others.

So, he has to just watch all these forces and try to maintain a volume of reserves that is close to the level that is considered desirable as he possibly can at any period. Therefore, you try to avoid giving him a very specific figure. He has to use a certain amount of judgment, operating within [illegible] directive.

COMMISSIONER MACKINTOSH: Is he ever given a direction as to the level of interest rates?

MR. THOMAS: Yes, at some times he is given that, such as the indication to keep the bill rate from falling much -- in fact, that has been a directive in the past year and a half: Keep the bill rate from declining. I think this directive that I had in here has a little interest rate factor in it. Paragraph 75 at the bottom of page 30 of my version:

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of the year) ..."

This was in December.

"... but with a somewhat slower rate of increase in total reserves than during recent months. Operations shall place emphasis on continuance of the three-month Treasury Bill rate at close to the top of the range recently prevailing. No overt action shall be taken to reduce unduly the supply of reserves or to bring about a rise in interest rates."

You can argue as to whether you need both directives but at this time there was a feeling that they didn't want to let the bill rate go down.

COMMISSIONER BROWN: How does he operate? Does he operate by quoting in the market, or does he operate by responding to other people's quotes?

MR. THOMAS: Well, he does both. If the operations are small he is likely just -- well, we have a trading desk there with half a dozen traders around a battery of telephones, and dealers are calling in all the time to report on the market, and if they have any offers they are likely to say, "Are you interested in this?", whether they are purchased on treasury or some agency account. They also operate for foreign central banks. Dealers are likely to come in and say, "We have such and such: Would you be interested in it?" Certainly, if there is pressure on the market they will be coming in and saying, "We have got to sell something", or, "We want some

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R.P.'s.", or, "We have a little of this and a little of that." So, if the operation is small they are likely to take up some of those offers that come in, but if you want to engage in a big operation you have what they call a go-around, and the traders at the desk will each take the name of three or four dealers and call as fast as they can and say, "What can you offer us?", and they will take down the offers by issues and by price, or maybe the dealer will say, "Let me think about it and I will call you bank", and within ten minutes they will have a sheet there of offers from all different dealers and they will go down, generally speaking, and will take those at the best price, or they may make some endeavour to distribute the purchases by types of issues so they don't get too many of one issue, and sometimes they will endeavour to distribute it as much as possible among the different dealers, other things being equal, and in that way they will buy as much as they feel they want to supply in the market, and what they feel they want to supply may sometimes be influenced by the volume of offers. If there are a big bunch of offers at what seems to be reasonably low prices it may be an indication, in itself, that the market needs assistance and they may supply more at the end than they would when they started out. However, generally they will have a rough figure in mind as to what they will need to buy in order to supply the reserves they need to supply for that period or vice versa on the selling. If they can't get it that way they may go out and offer the

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dealers and lower the rate to encourage them to come in.

COMMISSIONER BROWN: You mentioned they also operate for foreign central banks?

MR. THOMAS: Yes. The foreign department of the banks will give the security department the orders for the foreign central banks. Some of the operations for foreign central banks may be done directly through the system. If the foreign central bank wants to buy and the market is strong and you don't want to put any more pressure on the market, the system may sell directly from the system account to this foreign central bank, and the net result of that would be a reduction in the reserve availability, assuming the foreign central bank drew the funds in from the market. If the foreign central bank is buying out of funds alrady on deposit with the Federal Reserve, it is a wash operation, but still the result in the long run would be a drain on the market because the foreign central bank will either replenish its balance or has previously built up a balance. This is foreign central banks and governments.

COMMISSIONER BROWN: Would you care to tell us about the role of the Federal Reserve in the weekly bill auction?

MR. THOMAS: On the weekly bill auction, because of this provision that the Federal Reserve cannot buy from the treasury, for a long time the Federal Reserve never entered the auction at all.

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All during the war when we were supporting the treasury bill rate at 3/8 per cent we sort of had an understanding with the dealers they would buy bills and turn around and sell them right back to the Federal Reserve with a very small commission on it -- I forget what it was now. Even though the Federal Reserve held practically all the bills, and was generally just a roll-over, you had to replace the bills that you had and you had to go through this process of going through a dealer and getting him to bid for you. Finally, they came around to deciding -- well, actually the treasury in its offerings of bills said, "We will accept either cash or maturing bills as payment". There it was ruled to be an exchange operation. The Federal Reserve can exchange any of its maturing issues for a new issue without considering that this is a purchase direct from the treasury. So, now what the system does is to put in a bid like every one else for new bills up to the amount of its maturing issue; never any more: sometimes less, depending on whether for policy purposes you want to have some bills run off. The option is done on Monday; the bills are taken up on Thursday, so the decision has to be made on the basis of a projection as to what the reserve situation would be the following Thursday. Frequently, however, a good guess can be made as to that: we know what certain factors that may come into the market at that time will be, but, generally speaking, the system will put in the bid and by the time it puts in its bid there has been an exchange of views on the market

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and you have a fairly good idea as to how the bidding is going and put in the bids so that you will be sure to cover, or maybe put it in very close, so that if there is a bigger demand than they thought there was going to be the system may not get all of its bid, but that is sort of one way of keeping the market on an even keel. Generally, it bids the same way anybody else does except for the limit of the maturing issue.

COMMISSIONER BROWN: I have one question I would like to ask on reserve ratios. You mentioned that now they count the till money in the measuring of the reserves?

MR. THOMAS: Yes.

COMMISSIONER BROWN: Formerly they didn't, and my question is, why was the change made? Did they find the other not practical, or not accurate enough?

MR. THOMAS: No. It was a matter of equity as between individual banks. For all practical purposes Federal Reserve notes held in the vault of the bank is the same as a balance with the Federal Reserve Banks so far as the banks' necessity to obtain reserve funds goes. From the standpoint of the pressure on the market both are obligations to the Federal Reserve Banks, and for the bank to obtain any form of clearance he has to go to the Federal Reserve Bank and draw on its reserve balance. By not permitting these balances to count there was also a tendency on the part of the banks, when they got more cash than they needed, to ship it into the Federal Reserve, and

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this was particularly true over the weekends: they would ship in a lot on Friday and come back and get it on Monday morning, which didn't serve any useful purpose. Then there were some banks that found it necessary or felt it was necessary to hold odd amounts of cash in other banks relative to their deposits. Banks that were far removed from the Federal Reserve Banks would hold more than those that were close to the Federal Reserve Banks, and since they served the same purpose, there were restraints on credit expansion; there were non-earning assets, and it was decided it would be more equitable to permit them to count this cash as part of their reserve balances for meeting required reserves. That was basically the reason why it was done.

Originally, the reason -- in fact, in the original Federal Reserve Act they were permitted to count cash. It was discontinued in 1917 during the First World War as a way of drawing in gold from the member banks, into the reserve banks, and also was continued on the grounds it would be an encouragement for the banks to draw out gold rather than hold it in the basic reserves of the reserve system.

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There was some misunderstanding about that, not only on gold but on the significance of gold cash. I knew of one very large bank who held several million dollars worth of Federal Reserve notes in its vault in the 1930's at a time when it had excess reserves because they said they did not want to put their deposit in the Federal Reserve Bank because the Federal Reserve Bank would then buy securities with it. They did not understand that Federal Reserve notes were issued by the Federal Reserve Bank in exactly the same way as the Federal Reserve deposit.

THE CHAIRMAN: We will adjourn now.

MR. THOMAS: I am glad to end on a note of levity.

THE CHAIRMAN: It is very appropriate. If it is not inconvenient to you if we meet at a quarter to nine in the morning then we will be sure to finish before the noon recess. You wish to get away and probably some of the members do.

--- Adjournment.

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Royal Commission on Banking and Finance

Hearings held at

OTTAWA

Vol. 33

Date. July 20, 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,
Ontario, on Friday,
July 20th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

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Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - -

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Friday, July 20, 1962.

---AT 8:45 A.M. THE HEARING RESUED:

THE CHAIRMAN: We will now resume.

COMMISSIONER BROWN: Mr. Thomas, I have two or three questions that I would like to catch up on that I omitted to ask yesterday. The first one is what type of securities are eligible for purposes of resale agreements -- straight money market securities, or are there others?

MR. THOMAS: Let me look that up. This is specifically set forth in the authorization of operating procedures that is adopted by the Open Market Committee once a year and it reads as follows:

" The Committee reaffirmed the existing authorization to the Federal Reserve Bank of New York to enter into repurchase agreements with non-bank dealers in U.S. Government securities -- an authorization that had been reaffirmed by the Committee each year since it was first granted in this form on August 2, 1955. The authorization, which continued to be subject to the understanding that repurchase agreements at rates below the discount rate would be used only sparingly, specified the following conditions:

1. Such agreements

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(a) In no event shall be at a rate below whichever is the lower of (1) the

" discount rate of the Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills;"

It cannot be lower than one or the other of those. It can be higher than the discount rate as I said yesterday --

"(b) Shall be for periods of not to exceed 15 calendar days;

(c) Shall cover only Government securities maturing within 15 months; and

(d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.

2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee

3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System Open Market Account."

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COMMISSIONER BROWN: I wonder if you would also give us the reserve requirements of various banks that are not members of the Federal Reserve system, that is, the limit which is placed upon their reserve requirements?

MR. THOMAS: Well, they vary quite considerably among the states but mostly their percentage figures are similar to the percentages that are set by the Federal Reserve for member banks. Some states, the largest states at any rate, have authorized their banking boards and banking commissions to make adjustments and they generally make the adjustments any time that Federal Reserve changes their requirements but that is not universally true. In some states they have no such legal requirements. I think the State of Illinois has none. In the State of Louisianna they can hold certain state and local government securities as reserves and there are variations of that sort.

There was one important difference that no longer exists and that was that the non-member banks counted their vault cash, as well as balances held with other banks, whereas until 1958 or 1959 the member banks could not count vault cash. Consequently, even though there was the same percentage figure, the non-member bank had in effect a lower requirement if vault cash was included. Member banks have to hold their required reserve in the form of vault cash or balances in the Federal Reserve Banks, and in addition need to maintain for working purposes balances with other banks.

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In actual practice when you compute the total cash holdings of banks relative to their total deposit liabilities their differences are not very great. The banks, as a matter of practice, tend to hold up to as much as 25% of their demand deposits in the form of cash in vault balances with the Reserve banks, and balances with other banks, and that ratio does not vary greatly. It does vary to some extent but not too greatly. Most of the non-member banks are small banks anyhow. It does not make a great deal of difference. Theoretically it can make a difference at some state as in a tight money situation of some sort when the banks were squeezed, the non-member banks would have a little advantage.

COMMISSIONER BROWN: Is there any difference between the requirements for non-member banks that are in the deposit insurance scheme?

MT. THOMAS: Not on reserves, no. They are regulated as to the payment of interest on demand and time deposits. They are prohibited from paying interest on demand deposits and the Federal District Insurance Commission can set limits of its own to interest on time deposits which have always been identical with those set by the Federal Reserve. There is a little difference in the definition of what is interest and a long argument on it because the Federal Reserve has said that any bank that absorbs exchange charges on cheques payable by other banks obtained on deposit is in effect paying interest, that is, if the cheques come in for deposit and are sent to other banks and those

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banks charge exchange and the correspondent bank absorbs it, that is payment of interest. The Federal Deposit Insurance Corporation has as members a lot of non-member banks, who do not pay their cheques at par. They have ruled that that is not payment of interest -- an unsettled argument that has been running now for 25 years.

Mr. Brown, I would like to supplement an answer I gave you yesterday when you raised the question about why private individual investors in the States hold smaller amounts of government securities than in Canada. I think the answer is that most of our rich individual investors hold tax exempt securities -- securities of state and local governments and therefore they would be less interested in U.S. government securities. There possibly also is a greater tendency to hold equity rather than fixed interest securities in the States than there is here. I am not sure of that but I imagine that may be one factor but certainly the tax exempt feature must be a very important cause of it.

COMMISSIONER GIBSON: Following along Mr. Brown's question about reserve practices, you were mentioning yesterday the different reserve requirements for different kinds of banks against demand deposits and against time deposits. As I understand it the original idea of the different reserves against demand deposits was because of differing needs of liquidity particularly with the smaller banks carrying reserves in the larger banks in cities. You have narrowed this down to two specific areas, the country bank and

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the larger banks. What is the philosophy there? Has it the same ratio?

MR. THOMAS: Well, on this question I have views that are not necessarily those of the Board but let me say first, to get the points on which there is agreement or at least there is an official explanation, it is not now considered that reserve requirements are for liquidity purposes. The function of reserve requirements essentially is a control over the ability to extend credit on the basis of a given amount of reserves. Actually, a reserve requirement is not liquid in a sense; it is liquid for the purpose of meeting a short-term trend. It is there and can be drawn out but it has to be made up so it is not altogether liquid. It is there also in case of a bank failure or closing and it is an asset which is worth 100 per cent and not subject to any depreciation on the value. Generally it is considered that the purpose of reserve requirements are used as a fulcrum, that is, a control over the volume of bank credit and money supply.

The second point is the reduction in the classes of cities to two from three. We used to have a central reserve city classification of New York and Chicago banks, especially the larger banks. This change was made not at the suggestion of the Board but under pressure from the large banks over the protests of the Board.

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that it would be logical to have a uniform requirement for all banks so the protest may not have been too vigorous but, nevertheless, it was a majority view of the Board at the time and the unanimous view of the Board that they were not prepared to recommend a uniform requirement partly for very practical reasons.

It is very difficult to get uniformity given a differential that exists without them raising requirements for country banks or lowering them for city banks. This is not only politically unfavourable but also from the standpoint of the effect on the economy exceedingly difficult to raise requirements for any class of bank. It requires them to liquidate assets they have carried for some time and the lowering of requirements for city banks would release a great many reserves faster than would seem advisable and as always whenever any lowering of reserve requirements takes place there is always a pressure towards distributing it over as many banks as possible.

After all, there are more country banks than there are city banks and they have runs on them too. So it was practically exceedingly difficult to bring about a state of uniformity although it might be accomplished over a period of time and the American Bankers' Association made a recommendation to that effect.

COMMISSIONER GIBSON: Uniformity would be as good as or better from a standpoint of monetary control?

MR. THOMAS: From the standpoint of monetary

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control there we get into differences of opinion and theory. I happen to hold the theory that I think there are differences between types of money and that these differences should be recognized in the reserve requirements. The very fact that we have a difference in requirements as between demand deposits and time deposits, for example, recognizes that there are differences there. There are people who would argue doing away with all reserve requirements on time deposits. I think the Commission on Money and Credit had a recommendation in that direction or at least a suggestion which seems to me to be inconsistent with the idea that you should have a uniform requirement against time deposits which they also recommended because if there are differences in money quality as between demand deposits there are also differences as between money qualities in time deposits. It is a very difficult concept to measure what these differences are. We can measure them by the turnover which is measured by the debits against chequing accounts but we know that they are over-stated, the differences, because there are certain financial accounts that turn over very rapidly. Take the dealers in government securities, their deposits turn over many times every day and they have a time deposit at the end of the day which is only a fraction of the volume of transactions that go through their account in the course of the day. Always the general run of private individual personal account is certainly less than or not over once a month and often less than once a

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month or twelve times a year or less. The average turnover runs around 20 times a year -- in the country banks 15 times and around 25 in the city banks, 30 to 40 at the larger city banks. In fact, the Federal Reserve had a committee in 1931 to study the whole problem of reserve requirements, which made a recommendation for requirements that would be based partly on volume of deposits, partly on turn-over. That was never adopted and never really pushed. The Board was reluctant to push such a difficult scheme as that, although in my opinion it is the only logical way of facing this problem of the role of reserve requirements as a monetary regulator.

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That is one of the failures of my career with the Federal Reserve. I was never able to convince the Board that it should be done.

That is the theory of it, anyhow.

COMMISSIONER GIBSON: Thank you very much.

Would you care to say whether you think the relationship between the two ratios on demand deposits and the ratio on time deposits is fairly reasonable from a practical working point of view, again from the standpoint of monetary policy?

MR. THOMAS: Yes. There, of course, is no precise guide; it has to be by rule of thumb. It is going to depend very much on what the banks do about their time deposits. It has been an academic question heretofore.

We had the problem in the 1920's when there was a tendency on the part of banks to attract time deposits and a lot of funds which were really demand deposits were shifted into time deposits, and they were allowed to draw cheques on them. Since then we have a regulation which prohibits the payment of interest on demand deposits and limits payment of interest on time deposits. They have worked out a much more precise definition or rule as to what is a time deposit and what is a demand deposit, which we did not have before that.

In the nearly thirty years that that has been in existence we have not had any very good test of it because interest rates during most of the period were low. There was no tendency on the part of banks to pay very high rates on time deposits, or to attract

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them. They did not need to attract them very much, but gradually the rates on time deposits have risen. Recently the Board permitted the banks to pay as high as 3½ per cent on time and savings deposits, payable in from 6 months to a year and as high as 4 per cent on any such deposits that remain in the bank for as long as a year. This again is along the line of recognition of differences in the money quality of deposits. In respect of deposits of less than six months the bank cannot pay over 2½ per cent, and anything less than three months cannot be over one percent, and on anything less than 30 days, no interest can be paid. This gradation is in recognition of the distinction in the degree to which the deposits can be really considered as a savings or as money.

Now, as a result the banks have been competing more actively for time deposits. We have had in the past year a tremendous increase in time deposits. It began last year even before the rise in the interest rates, when there was a limit of 3 per cent. We are expecting the interest to be even more this year. There are some possibilities that given a situation in which it is attractive to banks to draw in time deposits and invest them profitably, the turnover of time deposits will increase. If we have a rise in the general level of interest rates, for example, there might be a tendency to make conditions a little easier for time deposits by relaxing the restrictions. We already see some signs of that. The Board spends a great deal of time making interpretations as to its

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regulations in respect of time deposits. Banks will come in with various sorts of a gimmick, and the Board must rule as to whether this is really a violation of the regulations or not. If it becomes true that a lot of pretty volatile money, or relatively volatile money, comes into time deposits, then I think this would raise a question as to whether there should be differences between different types of time deposits in reserve requirements. I doubt if that situation will arise or any such remedy will be recommended, but there could be a logical case for it.

I certainly think that the argument for having no reserve requirement against time deposits is not a justifiable one. It would be more logical, let us say, to see regulations extended to non-bank financial institutions which engage in similar activities than to do away with it in respect of the banks, because this is awfully close to money.

COMMISSIONER BROWN: If the percentage requirements are changed at any time what sort of notice is given?

MR. THOMAS: Well, if there is a reduction you do not need to give much notice. Sometimes they have made a reduction in the middle of a reserve period and made it effective at the beginning of the reserve period, but generally there is a little notice.

Of course, if requirements are raised, they try to give quite a lot of notice. The only time there has been any increase in requirement percentages recently was in respect

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of country banks, and it was raised from 11 to 12 per cent at the time they were permitted to count their vault cash as reserve and about a dozen banks throughout the country happened to have cash holdings considerably less than one per cent of deposits. In the main, country banks hold an average of around 4 per cent, so for most cases it was not any burden.

COMMISSIONER LEMAN: Mr. Thomas, there is one more weapon of control, that is used here in Canada, and that is the secondary reserves in banks. Your comments in respect of that subject are mainly concentrated in paragraphs 90 and following in your brief at page 37. I believe you indicate there that you believe that this liquidity factor is something for administration by the banks and you do not believe in it very much from the point of view of monetary control. Am I interpreting those paragraphs correctly?

MR. THOMAS: I think so. I also indicated yesterday at one time that they really are not means of monetary control unless the asset which is required to be held to satisfy the liquidity requirement is limited in its availability.

Now, the two aspects of monetary policy that are essential are that there be reserve requirements, and there be control over the availability of the reserve assets. The second in a sense is more important than the first. We have countries which do not have reserve requirements. Denmark banks have no reserve requirements, but they have learned that if they increase

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bank credit one or two things happen; it is accompanied by an increase in the demand for currency or it is accompanied by an increase in the demand for foreign exchange. The bank has to come immediately to the central bank to get funds to meet the currency demand or the foreign exchange demand, so they maintain conventional liquidity ratios. I think the same thing is true in Britain. They have no formal reserve requirement, but they have a well established tradition and practice. That would not work with us because we have 14,000 banks, each one having different standards, there would always be a few of them that would abuse the privilege. It would be exceedingly difficult to police.

I think the secondary reserve idea has been abused in a great many countries. They use it as a form of selective credit control to encourage the banks to put their money into certain types of assets rather than certain other types of assets, and then think they have regulated credit or money supply when actually they have only created an inducement to expand the money supply because the banks go into these particular assets.

One central banker in a European country said about the reserve requirement in general that he did not think they were necessary, that they were just devices to make it necessary for the central bank or commercial banks to buy more government securities. Secondary reserve requirements are frequently used simply for that purpose. It was a

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means of forcing the banks to finance a deficit. It certainly can be used for that purpose if you want, and some countries do use it for that purpose.

I do not have great confidence in the use of special or supplemental, or marginal, whatever you want to call them, reserve requirements as a means of monetary control. We played around with the idea in 1947 and 1948 at a time when it was felt that we had to support the market for government securities. This was one way of absorbing funds that we would create by supporting the market for government securities. It is a way of forcing banks to hold on to their government securities rather than selling them to the Federal Reserve and putting their money into something else. At that time a lot of sales of government securities were being made not by banks but by investment institutions, particularly insurance companies. It would not have been a solution, but it might have been better than nothing.

COMMISSIONER GIBSON: The basic thinking here of putting in secondary requirements, Mr. Thomas, is more directly connected with the prime responsibility and bank lending policy and changes in central bank practice.

MR. THOMAS: You can do that by controlling the cash reserves. In England they refuse to control cash reserves because the Bank of England accepts the idea that it has to buy treasury bills at a rate, so therefore they resort to liquidity requirements

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and regulate the availability of treasury bills through debt management. That works all right as long as most of the bills that are available are held by the banks, but if a lot of the bills are held outside and the banks can go and bid them away, I think it could break down.

COMMISSIONER LEMAN: On the average if we try to make a comparison between the United States banking system and the Canadian one, I think we should find that the cash reserve position is a little higher in the States than in Canada.

MR. THOMAS: That is right.

COMMISSIONER LEMAN: But in the States there is no secondary reserve requirement.

MR. THOMAS: I do not know that it makes a great deal of difference just how high the reserve requirement ratio is, as long as reserve availability is regulated. The lower the ratio the more control central bank can exert, because the expansion ratio is much greater and there is more leverage. You can argue either way on that one, but it is the degree to which they have the courage or conviction that they should regulate the availability of cash reserves that is important.

COMMISSIONER LEMAN: What I wanted to ask you, Mr. Thomas, has reference to the fact that the Federal Reserve nevertheless does watch the total liquidity of the banking system.

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COMMISSIONER LEMAN: Yes, but is it quite a scattered pattern of liquidity in the whole banking system in the States or is it fairly uniform?

MR. THOMAS: I think it is quite scattered, yes. You could work out averages that will show it is fairly uniform, but I think there is quite a variation within the averages. Each bank has a different liquidity need, and different ones have different concepts of their liquidity needs. Some are by nature more cautious than others. There is variation.

COMMISSIONER LEMAN: Does this come in again in respect of this distinction between country and city banks?

MR. THOMAS: Yes, the city banks have borne the brunt of a great many of the adjustments back and forth, so they try to get liquidity instruments. On the other hand they try to keep more fully invested. The country banks are likely to use their correspondent balances, which means that form of liquidity is a means of making adjustments. The country banks are likely to hold relatively as much or perhaps more non-earning liquid assets in excess of required reserves than the city banks. City banks would hold more in treasury bills, or Federal funds, or something of that sort, which they can shift into and out of, and at the same time get a return.

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that the bank's money is kept in use.

COMMISSIONER LEMAN: This is partly because the country banks keep balances with city banks?

MR. THOMAS: Yes, that is right.

COMMISSIONER LEMAN: Now the other subject I intended to ask you questions about is this. Is there a ceiling on loan rates in respect of members of the Federal system?

MR. THOMAS: A ceiling on loan rates; no.

COMMISSIONER LEMAN: There is no ceiling?

MR. THOMAS: Except in respect of the usury laws in the individual states. Different states have different requirements as to the ceiling on rates that can be charged on loans in general under usury laws. In some states they will have, say, an 8 per cent ceiling, but in a cotton region the farmer will come in and borrow from the bank, say $1,000 in April. He will get $920 credit, and he pays back that loan when he sells his cotton, which might be in October or it might be December; it might not be until March, but he pays back $1,000 and that is still counted as 8 per cent. So we find that average return on loans for banks at country banks in the south west may be around 10 or 12 per cent, even though the usury laws may say 8 per cent, or 10 per cent, or something like that.

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COMMISSIONER LEMAN: Well, many of the selective controls were briefly referred to yesterday. You mentioned the principal ones which have been used to a limited extent in the United States, such as the stock market margin requirements, finance company down payment requirements, and that sort of thing. Do you feel that those should be used only if there is some kind of a crisis developing?

MR. THOMAS: Well, I would not want to say much about that. I feel that the margin requirement control is basically essential. Because of our particular money market situation as it existed up to the late 1920's, liquid funds in banks and others were sent to New York to lend on the stock market; on the call money market for stock exchange loans. That tended to have a very important cyclical effect on the economy. The funds were put there when they were obtained and that stimulated the stock market. As economic activity increased, funds were shifted from call loans to business loans and pressure was put on the stock market. Eventually, generally in the fall of the year, we would run into money panics which created difficulties throughout the country, and the stock market declined. This would lead to decline our whole economy.

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They showed lags which were quite regular and logically consistent; better than our present system of leading indicators, which is sort of a mumbo jumbo, tea leaf reading, while the others had a logical consistency.

In the 1920's the Federal Reserve came in and relieved the pressures or made it possible to relieve the pressures by increasing the availability of credit. Stock market credit built up to a tremendous volume, and the only way of stopping that -- at least, it was felt one way of stopping it was to regulate it at the demand level, and that was done through margin requirements. Probably it is advisable to continue it, though volume of such credit is now a very small fraction of the total. Whether it would get any bigger if we had lower margin requirements or no margin requirements remains to be seen. It probably would. However, it is a very outstanding example of the speculative use of credit that can be unstabilizing.

I don't think we have other examples that are striking. Of course, during the war we had consumer credit control and also during the Korean situation, and probably it was partly effective, but the more important reason for holding down consumer credit was the limited availability of goods which could be bought on consumer credit.

Since the removal of the regulation consumer credit has moved up and down, but not very drastically and it hasn't been an important unstabilizing element in the economy. There is very little evidence that we need specific regulations on consumer credit.

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Besides that, it is an exceedingly difficult thing to administer. There are various ways of getting around such regulations. You have to regulate all retailers and dealers and all types of financial institutions. As legal and administrative problems become more and more difficult, the more restrictive it becomes. It doesn't matter too much when people don't want to borrow, but when they do, then it becomes difficult and the means of evasion get worked out more effectively. It is like foreign exchange control, and things of that sort.

Then, selective controls are only useable, I would say, or feasible in a type of credit in which you have a very specific collateral or very specific terms of re-payment. It is practically impossible to use them for something like business inventory credit. When a business borrows nobody knows what it is borrowing for, borrowing to build up its own inventories and to finance its customers. You have to have a complete study of the sources and uses of funds of every business to really come to some conclusion as to what the credit is being used for. A lot of these loans are short-term and can be shifted from one bank to another, so from the administrative standpoint it would be exceedingly difficult, and I think impossible, to ever try to impose a selective control in business credit.

In the final analysis, what difference does it make? If the banks lend more for one purpose they have less to lend for the other, as long as the

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central banks exercises control over the total volume, which is the more important thing. It is what the public has in the way of money; it is far more important than the purpose for which the bank loans money in the long run.

COMMISSIONER LEMAN: But there are certain uses of money that have quite a lot of a different impact on the economy than other uses?

MR. THOMAS: That is right, but they are very difficult to control by just controlling bank credit. The Federal Reserve credit increases at the rate of a billion or two billion a year, and total bank credit increases somewhere from five to ten billion a year on their time deposits, and the total credits from all sources increases from 30 to 60 billion a year, and the uses that people make of their money is a great many times the volume of money outstanding, and to try to control just one small segment of the uses of credit that goes through banks is like trying to control the dog wagging his tail, I guess. It might work, but you can never count on it working and particularly if the pressures are great enough to be important; very likely the public is likely to be ingenius enough to find ways of getting around a regulation of that sort, and also you get new credit institutions organized to do a job which we prohibit the banks from doing. We are always prohibiting banks from doing something and then somebody comes in and creates a government agency to do what the banks are prohibited from doing. We find it in all countries.

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COMMISSIONER LEMAN: But besides all these administrative difficulties you mention, and which are noticeable in this field of selective controls, does it come back to your basic objective of maintaining operation of free markets?

MR. THOMAS: That is right, and regulating the over-all money supply, the over-all volume of bank credit, which creates the money that becomes available to the public and the public decides what it will use it for. Keep your eye on the main objective and then you have to use other devices for regulating what the public does with its money, but you can't control the use of money by deciding what the Federal Reserve puts its into or even what the banks put their money into.

This is not saying that it couldn't regulate the nature of bank loans and investments; one does that for reasons of solvency and soundness and the ensuring of the banks' ability to meet their obligations under all conditions, but it is not necessarily a monetary regulation.

COMMISSIONER MACKINTOSH: If we could ask you a few questions about the near banks or the non-banks intermediaries. In your submission, Mr. Thomas, you have a fairly long quotation from Mr. Riefler's submission to the Radcliffe Committee in which he draws a sharp distinction -- he says at one point at page 46 of your submission:

"This distinction between commercial banks and other financial institutions is

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"This distinction between commercial banks and other financial institutions is

a crucial one. It springs from the fact that commercial banks, in contrast to other lending institutions, can expand or contract credit on their own initiative without bidding prior savings from the public."

Now, it so happens we have had another brief submitted to us -- although we haven't yet discussed this -- that quotes a statement from R.S. Sayers, which says:

"The distinction between banks as the creators of credit and other forms as users or intermediaries in the monetary field is, if not completely false, at least misleading."

Then he goes on to say:

"The crucial step is that which increases the power to acquire goods and services on the part of people inclined to exercise it immediately. Banks are by no means the only firms to place this power in the hands of others."

How sharp do you think this distinction is between the so-called near banks and the banks? There is no question about there being a substantial distinction, but is it a matter of degree?

MR. THOMAS: It is decidedly a matter of degree, but there is not a sharp distinction because it gets down to a question of what is it you decide is money -- if you want to call it intervention, that is an invidious word -- but the use of the non-bank institutions certainly must have an influence on

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facilitating the flow of money, the use of money, from holding an idle balance into more active investment, and to that extent it unquestionably has an influence on the whole level of economic activity.

COMMISSIONER MACKINTOSH: You wouldn't try and base a distinction on the contention that commercial banks create credit?

MR.THOMAS: Yes, I think in the final analysis it is the commercial banks who do create the credit and hold the really ultimate liquidity; the other institutions can only lend what they get. In a sense an individual commercial bank can only lend what it gets, but it is likely to get in the first place the increased reserves that are made available and it is the first stage of putting these funds into circulation; the reserves all come back into the bank system.

COMMISSIONER MACKINTOSH: That is the first stage, but ---

MR. THOMAS: It is the stage which makes possible the expansion in the total volume of money. It is, of course, true that when a deposit is used to pay an insurance premium -- the insurance company makes a mortgage loan -- you have an increase in total assets of the economy. When that money comes back the insurance company puts it back into the bank and unless it use/it to buy securities from the bank or pay off a loan from the bank, there is an increase in the total volume of assets, and that is the reason I say that bank credit is only a fraction of all credit, but still from the standpoint of liquidity,

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which is the factor that influences the speed with which the economy can expand or contract, banks are the ultimate source of liquidity and they are the ones that can be more effectively controlled.

I think that Riefler makes the point -- if he doesn't make it here, he has made it -- and the point which I endeavour to make here is that we do not ignore liquidity. Liquidity, through non-bank credit, is taken into consideration, and monetary policy has to be adjusted to it. The only thing we can control through monetary policy is what the banks themselves do. If the other institutions are providing the credit needs of the economy, there may be less need for bank credit than there otherwise would be. 1959 was an example of this.

It is not that the non-bank institutions are unimportant and outside of the realm, but they are the ones that there is less control over and less need for control over. Control can be largely exercised through regulating the availability of reserves to the banking system.

COMMISSIONER MACKINTOSH: You would see no need for extending reserve requirements to any of these institutions?

MR. THOMAS: Only in the cases where they set themselves up to provide liquid money that can be withdrawn on short notice or on demand, and thus serves the function of money.

Take our savings and loan associations which attract savings and which are really, for all

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Take our savings and loan associations which attract savings and which are really, for all

practical purposes, payable on demand -- at least most people think so and they have been in most cases. Although if they get into a tight place, they are not obligated to pay as promptly as banks are obligated. Yet actually the turn-over of their deposits -- the volume of their withdrawals -- is a small fraction of their total deposits outstanding. It is about once every three years, whereas the time deposits of commercial banks seem to turn over about once every two years, and mutual savings banks deposits about once every three or four years; that compares with a turn-over on demand deposits, that ranges from 12 to 20 or up to 30 or 40 times a year. It is hard to make a very strong case for imposing reserve requirements on these various savings accounts, but if withdrawals from them should become an active element in the use of money, then I think some moderate reserve requirement would be appropriate.

COMMISSIONER MACKINTOSH: And you base it pretty much on the rate of turn-over of their deposits?

MR. THOMAS: I would use that as evidence of whether it is needed or not. I don't know that I would base it necessarily on that, but usually it is evidence of the need.

COMMISSIONER MACKINTOSH: Thank you, that is all I have.

COMMISSIONER GIBSON: Mr. Thomas, I would like to ask you a question or two about the relationship between the Federal Reserve system and the government. You make certain comments on this subject in paragraphs

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12 to 19. In paragraph 13 you make this statement:

"In many respects the Federal Reserve is probably more removed from Presidential authority than other independent agencies. It is also administratively removed from the budgetary control of Congressional appropriations."

Would you care to develop the statement that it is more removed from Presidential authority than other independent agencies?

MR. THOMAS: Well, I don't know how I can develop it much. It is probably a matter of judgment to some extent. Control might be accomplished through the budgetary control over the expenditures. The Federal Reserve doesn't operate through the Federal budget or through appropriations by Congress, but I don't think that is the important part.

I think it is just a general recognition that the Federal Reserve is performing a function which has broad powers. Monetary powers may have very broad effects and the elaborate machinery for decision-making is designed to protect them from control of any one individual or any one group. The president should be careful about stepping into that sort of a situation. Woodrow Wilson definitely took the position he would not even consult with the chairman of the board, or the governor of the board as it was then. He didn't want to be accused of endeavouring to influence them. Senator Glass, who was the author of the Federal Reserve Act, and one time Secretary of the Treasury, and was also active in the passing of the Banking Act of 1935, which removed the Secretary of the Treasury and Comptroller of the Currency as ex officio members of the Board, took the position that the Federal Reserve should be independent of executive authority. The whole history of nations shows that the princes and kings and democratic governments have a proclivity for using the money-creating power for special purposes which has not always been advantageous or in the public interest.

COMMISSIONER GIBSON: This is related to the basic American approach to separated powers?

MR. THOMAS: It is partly related to the fact that in our country that we have separate powers of Congress and the President. Congress has delegated certain powers to independent agencies, but even with those agencies, that are subject to executive power,

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there is the view that there are limitations on the power of the president to intervene in the decisions of those agencies.

COMMISSIONER GIBSON: Has there ever been any presidential intervention with the Reserve?

MR. THOMAS: There was an attempt to intervene in 1951. President Truman endeavoured to call the open market committee in and tell them what he thought they ought to do.

COMMISSIONER GIBSON: These were the events leading up to the accord?

MR. THOMAS: Yes.

COMMISSIONER GIBSON: Could you tell us a little about that?

MR. THOMAS: I could tell you a great deal about it; I was very much in that. The situation was one where during the war the system had pegged the price of government securities, as had all countries, and unfortunately it pegged at a very low rate which happened to be existing at the time the war began as the result of a long period of depression and idle money. Gradually, in the post-war period, those pegs had continued, but we found it more and more difficult to exert control over the money supply and the availability of credit while continuing to buy government securities at a fixed rate and pegged at 2½ per cent long-term interest rate as the resources of the economy came more fully to be used, and in view of the very large volume of public debt outstanding, it made all this debt the same as money. The effects of this were

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ameliorated to some extent due to the fact that in post-war years there were very large budgetary surpluses. In 1949 a mild recession or adjustment in economic activity developed. But when the Korean situation broke out in 1950 it became evident there were going to be strong pressures on the economy. The public, remembering what had happened in the war, went into a surge of all sorts of buying and a wave of selling of government securities to the Federal Reserve. Interest rates were very low at that time. The Treasury put out a $1\frac{1}{4}$ percent note issue in August, 1950 against the advice of the system. The system had to buy up practically all of that issue in order to make it possible, and then sell something else to absorb reserves.

There was a wave of more and more of the holders of long-term government securities selling to the Federal Reserve. It became obvious something had to be done to stop that. The administration took the position they didn't want interest rates to rise. The Secretary of the Treasury made a speech on January 18th, 1951 that he would not have them rise. At a meeting of the open market committee in February it was decided that some increase was unavoidable. The President called a meeting of the committee and discussed the question with them. There was no very specific request to do anything. The chairman of the Board presented the situation, and the President made some nice remarks, but shortly after there was a statement by the President that he expected interest rates would not rise. The Open Market Committee wrote him a letter and said

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this was not a justifiable expectation. About that time the treasury was again facing a problem of financing, and the committee wrote a letter to the secretary of the treasury saying, "This is the programme we suggest following in order to get out of this." Mr. Martin was then an assistant secretary of the treasury, and he said to the secretary, "Here is a basis for discussion. Let us get together and discuss this." There was a group of three staff members from the Federal Reserve and three staff members from the treasury, including Martin as a staff member, who got together to work out a programme of action which would make it possible to get away from the pegs through a gradual process, and one feature of it was a refunding or an offer to holders of outstanding $2\frac{1}{2}$ per cent bonds to convert them into $2\frac{3}{4}$ per cent bonds that would be non-marketable but exchangeable for a short-term note at $1\frac{1}{2}$ per cent interest rate that would be marketable, which provided a little higher return for those who held the $2\frac{1}{2}$ per cents, so they could get out and at the same time not deprive them completely of their marketability. That was a device for assisting the movement. It was not an essential part of it, and that was finally agreed to by the secretary of the treasury and the open market committee after many days and long nights of work and discussion. From there on the process was gradually moved toward the freedom of the system to operate in the market as it saw fit.

COMMISSIONER GIBSON: The relative positions

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COMMISSIONER GIBSON: The relative positions

of the treasury and the board of governors are now pretty clearly established, are they not?

MR. THOMAS: Yes, I think you could say that. The then chairman of the board, Chairman McCabe, resigned and Martin was made chairman of the board and he is in force today. He has said that Federal Reserve-treasury accord came about not because of the working of any individual -- modestly -- but because it was absolutely necessary; there was no other alternative. However, it is a demonstration of the attempt of the executive to use his power which was resisted.

COMMISSIONER GIBSON: Would you say anything about the freedom of the Federal Reserve system from budgetary control of Congress. You said in your paper that the system is subject to the surveillance of the ---

MR. THOMAS: Yes.

COMMISSIONER GIBSON: Would you tell us just what that means?

MR. THOMAS: It means a lot of public hearings and a lot of questions. One member of the banking and currency committee was also chairman of the joint economic committee, and used that privilege very actively. He has studied all the budgets of the Federal Reserve banks and all the expenditures and reserve accounts, and the budgets of the board, but the system was freed from this budgetary control primarily by the provision of the Banking Act of 1935 -- or, maybe 1933 -- that was put in by Senator Glass deliberately for the purpose of making it possible for

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COMMISSIONER GIBSON: Do your officers spend a good deal of time explaining your policies to Congressional committees -- your senior officers?

MR. THOMAS: The chairman does most of it, or sometimes some member of the board will do it; but it is mostly the chairman. The staff of the board has to work on preparing testimony and material and so forth. A great deal of time is spent not only on policy matters but also on the detailed inquiries, let us say.

COMMISSIONER GIBSON: Who takes the most interest in the Federal Reserve -- the Senate or the House?

MR. THOMAS: Right now it is Congressman Pottman who is going to be the next chairman of the banking and currency committee and is now chairman of the joint economic committee, but at times Senator Douglas has taken quite an interest, although his interest has been less than it was 12 or 13 years ago.

the system not to be unduly influenced even by Congress in its exercise of what he considered to be their monetary powers. The privilege has not been abused. The board is very strong in its budgetary controls both over its own operations and over those of the Federal Reserve banks. But there is a little more leeway and it does remove the possibility of a particular group of Congress saying, "We will approve your budget if you do a certain thing", and makes it necessary that if Congress wants to disapprove of the monetary policies followed by the system it will do it directly and not indirectly.

COMMISSIONER GIBSON: Do your officers spend a good deal of time explaining your policies to Congressional committees -- your senior officers?

MR. THOMAS: The chairman does most of it, or sometimes some member of the board will do it; but it is mostly the chairman. The staff of the board has to work on preparing testimony and material and so forth. A great deal of time is spent not only on policy matters but also on the detailed inquiries, let us say.

COMMISSIONER GIBSON: Who takes the most interest in the Federal Reserve -- the Senate or the House?

MR. THOMAS: Right now it is Congressman Patman who is going to be the next chairman of the banking and currency committee and is now chairman of the joint economic committee, but at times Senator Douglas has taken quite an interest, although his interest has been less than it was 12 or 13 years ago.

In fact, Senator Douglas's inquiry of 1948, in the recommendations he made, gave a very strong basis for the Federal Reserve Treasury accord. The Chairman of the two banking committees also are actively interested.

COMMISSIONER GIBSON: Do you feel you are reasonably successful in keeping members of Congress in touch with what the Federal Reserve system is trying to do?

MR. THOMAS: I doubt if there is any agency of government anywhere in the world that provides more information as to its activities than the Federal Reserve system, except, of course, the legislative agencies and the courts where nearly all their proceedings are public.

COMMISSIONER GIBSON: Do you get constant questions, or do you only get questions when a finance committee of the House or the Senate is operating?

MR. THOMAS: We get frequent questions, sometimes by telephone and sometimes by letter and sometimes by official inquiry through committees.

COMMISSIONER GIBSON: Are questions asked in the House of Representatives and in the Senate on the floor about your activities?

MR. THOMAS: No member of the executive department appears on the floor of Congress, so they are more likely to be asked questions in committees. Speeches are made on the floor about it every week. We had one member of the Senate who made a speech every Saturday at 4:30 -- in the 20's. COMMISSIONER LEMAN: In this context what was the meaning of comments in the

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commission report about making the term of the Federal Reserve board chairman concurrent with the president's term?

MR. THOMAS: That is thought to have been the original intention of the Act, but the chairman is designated for a term of four years, but as it was applied the chairman's term has never ended anywhere nea the term of the president, so that the new president does not have the right to designate a new chairman very soon in his term of office.

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I think Mr Martin's term as chairman will expire next year.

Now, you can argue either way on that. One of the reasons for making it possible for the president to appoint the new chairman has to do with ease of communication. It is more likely that the president will be willing to communicate with a chairman of his own choice than communicate with a man he does not have confidence in.

There are ways of handling that, of course. If the man is chairman and he feels he has lost or does not have communication with the president, and that the functioning of the system is being handicapped as a result, he can always resign his position as chairman. Or, if he feels through communication he would be subjected to a pressure to do something which he thinks would be undesirable he can stay and fight it out. Chairman Martin has taken the position that he thinks a change would be desirable.

COMMISSIONER LEMAN: Do you think it might have a tendency to cause the Federal Reserve system to be in closer co-operation with government policy on other counts?

MR. THOMAS: Well, I would like to get this off the record, if I may. This is not anything very important, but I would rather not put it on the record.

In the present situation --

THE CHAIRMAN: Well, Mr. Thomas, members of the press are present.

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In the present situation --

THE CHAIRMAN: Well, Mr. Thomas, members of the press are present.

MR. THOMAS: I will trust the press. I have talked to the press frequently, and on the understanding that they will not --

THE CHAIRMAN: Is that understood?

MR. THOMAS: This is not anything very spectacular. It is just a personal opinion about personalities, and I think it would be indiscreet for me to say things in public of this nature.

THE CHAIRMAN: Well, I think it would be preferable not to say it except in private conversation some time.

MR. THOMAS: All right, we will leave it out then. I think I have already said it to some members. It is just a personal view about the relations of the present chairman to the present president. Their relations are very fine. That is what I wanted to say.

COMMISSIONER BROWN: In respect to this relationship with the government, we discussed earlier collaboration or co-ordination of debt management and monetary policy. We have not really had any discussion about the collaboration on fiscal policy and monetary policy. You do mention it briefly in paragraph 17.

MR. THOMAS: Well, I think fiscal policy is something that is determined by Congress and the President, and it is a matter of legislation. The board can have views about it and has expressed views about it certainly to the treasury and to the members

of the Council of Economic Advisors, and they ask them to express views to Congress as to what would be the appropriate fiscal policy under the circumstances. This is a matter of opinion or judgment, but once that fiscal policy is decided then one of the things that you have to take for granted, is that the government is going to have to borrow so much money, or is going to be able to pay off so much debt, as the case may be, which is more rare, but if in borrowing that amount of money it puts pressures on the economy, you have the same problem as debt management. The pressures have to be permitted to be expressed and the treasury has to compete in the market for the volume of lendable funds that are available, and it is not a function of the Federal Reserve to make those funds available regardless of the need of the monetary situation at the time.

That is exactly what happened in 1959. The government had a big deficit and had a large volume of borrowing, and it had to compete in the market. It raised this money and showed definitely that you can have a government deficit which can be financed outside the banking system if the occasion calls for that sort of a monetary policy.

COMMISSIONER MACKINTOSH: Did it handicap you in doing that by the maximum rate on government debt?

MR. THOMAS: Yes, it definitely did so. The maximum rate applies only to bonds which have an initial maturity of over five years. The treasury

had to borrow on shorter term paper and it was put at 5 per cent for five year money. Now, it is possible that under those conditions the Treasury might have been able to borrow long-term money at $4\frac{1}{2}$ per cent, because the long-term investors would say: Well, if we can get $4\frac{1}{2}$ per cent for this period, we better take advantage of it, it may not last.

Now, the question as to whether you save money in the long run by borrowing for a short time at 5 per cent or a long time at $4\frac{1}{2}$ per cent depends on your judgment as to what the average level of interest rate is going to be over the next five to twenty years.

COMMISSIONER LEMAN: Well, in respect of matters like ceilings on interest rates for long-term debt of the Federal government in the United States, I suppose the Federal Reserve officials may be consulted as to what they think in respect of these matters when there are hearings, et cetera? Are they matters in respect of which they would volunteer counsel to Congress?

MR. THOMAS: I am not sure exactly how that worked out, but actually in those hearings before the House Ways and Means Committee, the Chairman of the Board actively took part. Whether this was at the request of the Secretary to the Treasury or at the request of Congress, I do not know. The Chairman and staff members sat through, not only public hearings, but also the executive sessions of the committee in writing its bill. It was a very interesting ex-

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perience.

COMMISSIONER GIBSON: Is there quite a lot of communication between the senior officers of the Board of Governors and the Treasury, or Council of Economic Advisors?

MR. THOMAS: Yes.

COMMISSIONER GIBSON: Do these people see each other quite a bit?

MR. THOMAS: Quite a bit.

COMMISSIONER GIBSON: Do they bang ideas around together?

MR. THOMAS: Yes.

COMMISSIONER GIBSON: In other words there is a constant process of discussion going on?

MR. THOMAS: Yes, on interdepartmental committees, the Federal Reserve staff is likely to be represented. The preparations and projections of economic activity for the purposes of estimating possible budget receipts are worked out by this interdepartmental group, on which the Board's staff is represented. There is constant contact; almost daily contact with Treasury people in respect to one item or another. There is a formal or informal luncheon, as the case may be, every Wednesday. There is direct contact between the Chairman and the Secretary frequently, particularly in respect of any important matters. The Chairman

of the Council of Economic Advisors and other members of the Council of Economic Advisors and members of the Board probably meet either formally or informally once every two or three weeks.

COMMISSIONER GIBSON: Going down the line a bit, do you encourage your officers to meet with Treasury people and so on?

MR. THOMAS: Oh yes, yes.

COMMISSIONER GIBSON: You are not afraid that they might get their ideas changed?

MR. THOMAS: There is a mutual interchange, if you have enough confidence in your own power of convincing them. The report of the Council of Economic Advisors is distributed around many government agencies and read in the staff of the Board. It used to arrive every year on Christmas Eve. Then they changed the date so it could come on New Year's.

COMMISSIONER GIBSON: You say, Mr. Thomas, that you have a competitive system of ideas in Washington?

MR. THOMAS: Decidedly, yes.

THE CHAIRMAN: We will adjourn now for ten minutes.

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THE CHAIRMAN: We shall now resume.

COMMISSIONER HARROLD: Just a question or two about the section on organization of personnel of the Federal Reserve System.

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COMMISSIONER HARPOLD: Just a question or two about the section on organization of personnel of the Federal [illegible]

twelve Federal Reserve banks and 24 branches. You say its officers and employees are residents of the Federal Reserve district, and its transactions are with regional and local banks and businesses. What other actual businesses does it carry on business with besides the banks as such, and what kind of business?

MR. THOMAS: Well, actually from the standpoint of business I am not sure that there is much except the usual administrative procedures of operating a bank in respect of things like purchases of supplies and insurance and payments of local taxes. That is a governmental thing, of course. They operate pretty much as a local business organization would operate from the standpoint of those matters.

Of course, acting as fiscal agents for the treasury, they would have a lot of contacts with business collecting and setting up tax and loan accounts, and tax payment receipts, and social security taxes, but most of those would come again through the governmental agencies. Most of the business is with banks. There is not much contact with business.

COMMISSIONER HARROLD: I suppose there would be practically no contact with the general public as such in respect of ordinary banking transactions?

MR. THOMAS: That is right.

COMMISSIONER HARROLD: Of the 24 branches there are not necessarily two located in each region?

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MR. THOMAS: No, it depends on the region. New York has a branch at Buffalo. Philadelphia has no branch. Richmond has a branch at Baltimore and one at Charlotte. Cleveland has a branch at Pittsburgh and one in Cincinatti. Chicago has -- I do not believe Chicago has any branch; oh, Detroit, of course, yes. St. Louis has a number of branches; Louisville, Memphis, Little Rock, Jacksonville, Burmingham, New Orleans and Nashville. St. Louis has a branch in Memphis as well. Minneapolis has one of the longest districts but has a branch only in Helena, Montana. It is very far removed. San Franciso has branches in Seattle, Salt Lake City and Los Angeles. I think that is all. Kansas City has branches in Oklahoma City and Denver. Dallas has branches in San Antonio, El Paso and Houston.

I am not sure that I named them all, but there are a great variety depending on the distance, the geography and the location of centres.

COMMISSIONER HARROLD: It depends more on convenience because of geographic reasons than for any other reason?

MR. THOMAS: Yes, the branches are used for paying out currency and for clearing cheques and for handling fiscal agency functions rather than for any particular policy reason, although the branches also will be making discounts or money advances to member banks when they have occasion to do so.

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COMMISSIONER HARROLD: In the statutory qualifications in respect of the Board of Governors, it is mentioned that they cannot be officers or directors of any bank or banking institution, trust company or Federal Reserve bank. What is the definition of a banking institution of which they cannot be a director or officer?

MR. THOMAS: That means any commercial banking institution. I think there are some fairly definite legal definitions of what is a commercial banking institution; an institution that accepts deposits primarily and provides a chequing function. I suppose it would also include mutual savings banks, too, perhaps. It would not necessarily include what we call investment banking, although as a matter of practice very few of them are likely to be directors. If they were they would have certainly to break their connection.

COMMISSIONER HARROLD: On the question of the regional type of organization you attach considerable importance to this, I believe. Does this involve a question here again of convenience in having the central bank system spread over the country because of geographical reasons?

MR. THOMAS: I think there are various reasons why the regional set up is useful which do not necessarily impinge on the functioning of the monetary system in its broad theoretical sense.

The Federal Reserve Banks, of course,

exercise a great many administrative functions; the clearing of cheques, the provision of currency as well as fiscal agency functions. These are pretty big jobs, actually, and they are the things that take up most of the personnel and involve most of the work.

Having the Federal Reserve Bank president on the Open Market Committee, this gives them a broader sense of participation in the formulation of monetary policies. The whole idea that each Federal Reserve Bank might formulate different policies has been found not to be workable. The policies have to be national in scope, but there is an advantage in knowing that these very high grade Reserve Bank officials do keep in touch with regional situations. They have a lot of contact with business men and bankers, and at the same time are in a true sense of the word public officials with public responsibilities. They bring to Washington a great deal of broad useful advice and judgment. They take their jobs very consciensciously and work very hard at them.

Also they serve a useful purpose from a public relations standpoint, and a public education standpoint in giving a better understanding of the functioning of the system, and why it does these things in the local community. It gives a feeling of participation. The same thing is true in respect of the directors of Reserve Banks. Their actual powers in formulation of monetary policy are exceedingly

limited, but the fact that they are there, they keep informed and they know about these things and why they are done, is very helpful in managing the banks, and worthwhile from the point of view of their bringing judgment to the bank as directors of big institutions of that sort. They are particularly helpful in giving an understanding and in understanding and transmitting that understanding of the functioning of the system throughout the country.

We have a practice every year of -- the Board has -- of adding, in every one day or day and a half session, all new directors that happen to be appointed. In that particular year banks and branches may have as many as 50 or 60 that enter, and sometimes they are very prominent business men and bankers and some of them who formerly worked for the Federal Reserve System in one capacity or another, but they come in and get an explanation of how we function and why, and it is a very useful educational and public relations device and also exceedingly helpful in getting from them their informed judgment and their opinions and the information they have on what is going on and what the reaction of a country is to what is going on.

We think this is very useful and we would think that the universal feeling would be throughout the system that it would be a great loss if the regional system were ever abandoned. I am not sure it could not be set up anew; you could make a stronger case for it than was made at the time, but it has worked very well and is very useful.

COMMISSIONER GIBSON: It is closely related to the banks throughout the country?

MR. THOMAS: That is right; we have closer contact with the individual banks and it gives them a feeling of local participation.

COMMISSIONER HARROLD: You have some comment to make on the Board of Governors from the standpoint of financial, agricultural, commercial

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COMMISSIONER HATFIELD: You have some comment to make on the Board of Governors from the standpoint of financial, agricultural, commercial

and investment dealers.

MR. THOMAS: On the Board of Governors there is a question as to whether they could be said to represent any interest. Every member of the Board considers himself as representing the broad public interest and not representing any particular interest. That is one point of view that we generally like to encourage, that a member of the Board is not there to look out for bank interests or business interests or agricultural interests. There is also a great deal of pressure from labour people to have a labour man on the Board. We have members of the Board who are informed about labour matters; the vice-chairman was a professor of industrial management in the University of Pennsylvania and he is well informed on the subject. The hope is that they can avoid having the feeling that any member has to represent some particular interest.

COMMISSIONER HARROLD: You would not suggest that it should be limited to the men with financial experience?

MR. THOMAS: Well, sir, it is very helpful to have the people with different types of experience. There should be some member who has had banking experience and somebody who has had business experience. We sometimes think there ought to be more economists on the Board, but there are some advantages in having people who have had diverse experience and let them learn economics to the extent to which they need to learn it from the staff and from

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other Board members occasionally academic people recommend that the Board ought to be made up entirely of economists, but I think that would be unfortunate, too!

COMMISSIONER HARROLD: In that the Board of Governors are on a full time basis, after being there a while they are not looked on as inside people, but rather people with outside interests?

MR. THOMAS: Well, they maintain their breadth of interests. They are very hard working people. The Board meets every day unless there is no occasion to meet and they work things out as a team. They do not divide their responsibilities, although in some matters, like bank supervision, there may be one or two members of the Board who will be relied upon more because of experience in that field, but in general they all take responsibility for everything. This means they all have to be pretty well informed. They take their responsibility very seriously.

COMMISSIONER HARROLD: In the operation of the Open Market Committee as such, would you say this was a combination of views, rather than being a view by the Chairman as to what should be done from day to day?

MR. THOMAS: Oh, decidedly, decidedly. The Chairman has one vote and one voice. Of course, the power of the chairman depends upon his powers of convincing the other members, and if he is a very

convincing person he can have quite a lot of power. Sometimes other members have a great deal of power just from the standpoint of the veto.

The Committee likes to have a broad concensus and sometimes when there is a question comes up on it there is no strong feeling and one person has a very strong feeling against it, it may hold the decision up for quite a while. That is generally true more on procedural matters than on broad policy, but it is true and there is a great advantage in having many members participate in this discussion. It is helpful from the standpoint of the staff in that any special person who wants to present a point of view can generally find some member who will support it, and the board and the committee in general do not object to differences in points of view. We all feel quite free about things; if we think you are making a mistake, we say so.

COMMISSIONER GIBSON: Would it be all right for the staff to speak to another member of the board other than the Chairman?

MR. THOMAS: Oh yes.

COMMISSIONER GIBSON: And express a point of view to this board that the chairman might not agree with?

MR. THOMAS: Decidedly, decidedly, and at a meeting of the Open Market Committee generally each member makes up his own mind; the Board does not get together and say, "We will state this particular

point of view as a board.".

Sometimes individual members of the Board will come into my office and they will go into the offices of other members of the staff and say, "Now, what do you think we should be doing on this situation?" and if we have no views -- frequently I have not made up my mind myself until about ten o'clock the night before as to what I am going to recommend, because I want to study the whole situation pretty carefully before I make up my mind, but you can express your views or questions and you do not have to agree with what the other board member says or thinks, and primarily he wants you to speak when you do disagree because in this way he can develop his own arguments. A member is not of any value to the board if he cannot present his own views.

COMMISSIONER GIBSON: Are the board members in the majority of cases able to discuss the technical matters of monetary policy in debt?

MR. THOMAS: Yes. Maybe not when they first come in as board members, but they learn awfully fast.

COMMISSIONER HARROLD: I gather at the moment you have no firm convictions or recommendations on changes that should be made in the present setup of the Board of Governors and regional directors, and so on?

MR. THOMAS: No, I am satisfied with it the way it is.

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MR. THOMAS: No, I am satisfied with it the way it is.

COMMISSIONER HARROLD: Has there been discussion in Congress over pressures in Washington within the last few years for changes in the present setup?

MR. THOMAS: There has been a suggestion that the Board be reduced to five members; suggestions that -- I think the Commission on Money and Credit suggested that the Open Market Committee be done away with and that the Board take over those powers, but I think that would be a mistake.

COMMISSIONER HARROLD: You mention that in the regional areas there is some interchange in personnel with the University faculties as such; is that very extensive?

MR. THOMAS: Yes, it is quite extensive. We have a hard time getting people away from universities now that they are paying such big salaries! However, we try to take advantage of the view that experience with the Federal Reserve is a very valuable experience for anyone who is going to be in the academic profession. Sometimes we can attract them that way, and once they come a lot of them -- a large number of them -- prefer to stay; they like it.

COMMISSIONER HARROLD: Would you regard this exchange as an advantageous one?

MR. THOMAS: Decidedly, yes, and then we have some groups of professors who come in and engage in free interchange of views; argument and differences of opinion are encouraged. Within our own staff we try not to

get a staff which is committed to any particular doctrine, but have different sorts of doctrines and prejudices. If we cannot deal with those, then we cannot be too sure of our own positions, so we try to get differing points of view in our staff and get free exchange of views among them.

THE CHAIRMAN: I would like to ask Mr. Thomas a question with reference to paragraph 158. It is stated there:

> "The Board of Governors is essentially a policy-making and supervisory body and has virtually none of the operating functions common to central banks. The operating functions of the Federal Reserve System are performed by the Federal Reserve Banks."

I take it that means by the twelve banks.

MR. THOMAS: Yes.

THE CHAIRMAN: I would like to get a picture, if possible, of just how that works in practice. Once the Open Market Committee comes to a definite decision as to policy, how is that transmitted through the system and carried on?

MR. THOMAS: Well, the task of carrying out open market operations is assigned to the Federal Reserve Bank of New York, and there is a manager of the Federal Open Market Account who has always been a vice-president of the Federal Reserve Bank in New York. Now, whether that is necessary might be subject to question, but it has

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actually worked out in practice; that he always has been. Of course, he has a certain amount of divided functions there; as a vice-president in the Federal Reserve Bank of New York, he may have other duties and be answerable to the president of that bank, but as manager of the Open Market Committee he is answerable to the Committee. The president of his bank has always been the vice-president of the Open Market Committee.

Now, they have a staff and an investment department of the Federal Reserve Bank of New York, which does the buying and selling of securities for the Open Market Account; they also buy and sell securities for the Treasury Account, for the foreign central banks and to some extent for the member banks.

If the member banks want to do it through the Federal Reserve bank rather than through a dealer, the Federal Reserve Bank will do this for them. It is not very widespread, and is generally for small banks. Dealers do not care about handling the small operations. All open market purchases and sales are carried out through this department.

COMMISSIONER HARROLD: So that it is a centralized operation?

MR. THOMAS: Yes, it is a centralized operation for the whole System. At first, in the early days of this System, each Federal Reserve Bank used to buy and sell securities for its own account, and the reason the Open Market Committee

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started was more or less an incidental discovery after the First World War when banks paid off very large borrowings that they had had at the Federal Reserve Bank during the First World War, and it was financed by the bank buying government securities and borrowing from the Federal Reserve to pay for them, which worked out to exert a considerable degree of restraint and it was one reason for the very rapid liquidation of credit that took place in 1921.

Then, after the discounts were paid off the Reserve Banks thought they ought to keep their money invested, so each one would go and buy government securities and they found that they were all operating in the market and having quite an effect on the market, and it was decided to concentrate these operations in one group, and they set up the Open Market Committee for this purpose, not recognizing fully that this also had an effect on the availability of reserves. Then, when they noticed that they did have an effect on the availability of reserves, they began to view them as an instrument of policy and had some regulation on it and that was generally run by the Federal Reserve Bank of New York, and it was not until about 1933 that they formalized this Committee and made it a body that functions for the whole system in a formal sort of way, this open market operation.

Now, the discount policy or lending to member banks directly, that operation is performed entirely within each Federal Reserve Bank in its relation to the member banks. The member has nothing

to do with that except the approval of the discount rate, which is generally fixed by the Board of Directors of that Federal Reserve Bank, although the Board in Washington does have the power to fix the discount rate.

Actually, the discount rate is generally discussed and there is an informal agreement on it at some meeting of the Open Market Committee, and then they go back and the rates are changed according to the schedule of the meetings of the Boards of Directors of the Reserve Banks, and generally there is uniformity over a very short period of time.

COMMISSIONER HARROLD: I take it the rates couldn't vary?

MR. THOMAS: They could vary.

COMMISSIONER HARROLD: But in practice they probably do not?

MR. THOMAS: They could vary, and there is room for argument as to whether they should. They have at times varied. We had a period a few years ago where two banks had rates of 3½ per cent and all the rest were at 3 per cent, but since most banks regulate their reserve position through the treasury bill market it does not serve much useful purpose for them to vary. The banks through Federal funds finance in the regions where they have these kinds of rules, but since the rate from other banks is below the discount rate, it is a question of whether it serves the same purpose.

We conjecture from time to time as to whether

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We conjecture from time to time as to whether

an occasion might arise when there might be reason for a difference, but nobody has yet found a very strong argument for it. I think that the principle is maintained that they can vary. On matters of issuance of currency and cheques and so on; these are just detailed operations that run almost automatically and there is no policy involved except the policy of how well prepared they are administratively. Some banks still use over-time to clear cheques when they get loaded up and others will not, or a few little things of that sort; but there is room for executive discretion in operating matters of that sort.

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COMMISSIONER LEMAN: Mr. Thomas, I think you have already explained to us that it was part of the policy of the Federal Reserve system to try to make sure when additional reserves are pumped into the system you want those quickly and well scattered throughout the whole system. The fact that all this starts from open market -- I am not talking about the discount window now where the reserves can go in according to the wishes of each bank, but the additional reserves created through open market operations. It is through their own administrative ability and through the functioning of the market that that takes place -- the scattering?

MR. THOMAS: The distribution?

COMMISSIONER LEMAN: Yes, the distribution.

MR. THOMAS: Frequently the distribution may have taken place before the Act. After all, most of the operations of government securities transacted through the dealers have head offices in New York, but they may represent purchases and sales made by banks and others throughout the country, and the funds may have already been transmitted out, and the pressure comes at the centre after the distribution has already taken place. But most operations, you see, are to take care of varying pressures that take place in the market. It is not often that you just pump money out and count on it being distributed. The money goes out because somebody wants it and needs it. The person who wants it has been selling bills or withdrawing bankers' balances, and the pressure comes into the market, or

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we know it is going to be there, and provision is made for taking care of it before it takes place if it is one of the normal seasonal movements. I don't think there is any great difficulty.

We do notice, for instance in 1958, when there was a series of reductions in reserve requirements, which certainly released a lot of funds, the big city banks put those funds to use very quickly and an exceedingly sharp drop in bill rates occurred. Country banks were slower in putting their funds to use, and they came in more gradually. Eventually, it was all reflected in the situation.

COMMISSIONER LEMAN: Has this ever been a matter of discussion? Has there ever been any argument that banks further away from the centre have somewhat of a disadvantage by reason of that?

MR. THOMAS: There is always some argument; somebody will raise that question, but I doubt if there is any very substantial basis for it because money is a very fluid thing, and the way our banking system operates it gets scattered around very fast, as I said, through our correspondent banking system and other devices. Any bank that needs funds can get them very fast. When redundant reserves are put out they may be slower getting around. We have noticed at times during the war and at times since when there was a very large Treasury deficit, the Treasury will tend to borrow its new funds from the city banks or in the central markets, and there is likely to be more

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of an outflow from, say, the New York or the central money markets throughout the country as the money is spent by the treasury out through the country. But it is very difficult ever to actually find out exactly what are the causes of regional flows. It is a very interesting study. We are always having some professor coming in and saying, "I would like to study the regional flows of funds", and we say, "All right, here is a mass of information", and they spend a year studying it and end up with no conclusions. Basically, it is a problem of trying to study the balance of payments of a region without knowing what the imports and exports are and other trade elements. All you know are the financial elements.

COMMISSIONER BROWN: In connection with this centralization of the marketing in New York, I assume there are facilities within the system for the same day transfer of securities?

MR. THOMAS: Yes. That is done through a wire transfer system.

COMMISSIONER BROWN: Between the reserve banks?

MR. THOMAS: And for all member banks.

THE CHAIRMAN: I am not quite clear just how the bank in New York operates.

MR. THOMAS: On the system of market accounts, you mean, and distribution as among the reserve banks?

THE CHAIRMAN: Yes.

MR. THOMAS: We have a formula for that and the holdings in the account are / allocated every day on the basis of a formula.

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A certain proportion goes to each reserve bank.

THE CHAIRMAN: So that the Bank of New York in New York sells certain securities and then those are distributed -- the proceeds are distributed?

MR. THOMAS: Distributed through our district clearing system -- what we used to call the gold settlement fund, which is done by machine every night in a few minutes.

THE CHAIRMAN: When the Bank of New York buys securities, it has to draw money from the various Reserve Banks to pay for it?

MR. THOMAS: That is right, yes. The formula is, in essence, based on the proportion of total assets held by each Reserve Bank, but there is an adjustment process to take into consideration the bank's reserve ratio. If one district happens to be losing funds and its reserve ratio gets down close to some minimum level that is agreed upon, its participation in the account may be reduced until there is an adjustment made in its reserve ratio.

THE CHAIRMAN: Well, the position of the bank in New York is really that of an agent for the system as a whole?

MR. THOMAS: That is right.

COMMISSIONER GIBSON: What does a governor do in a typical day? He goes to a meeting of the Board?

MR. THOMAS: He reads memoranda and other documents. Of course, he has a lot of people come to see him. However, they have certain administrative decisions to make about personnel and things of that sort.

COMMISSIONER GIBSON: There is some division of administration responsibility, is there?

MR. THOMAS: Very little. There is one member of the board assigned the responsibility for certain administrative decisions about personnel. Any decision he makes, I guess, is cleared through the board; they have a chance to look at it and raise objection -- certain decisions about leave and trips and things of that sort. He has the final authority on many matters, but when it comes to a question of employing a senior staff member, of course, the board members all have a chance to look at that.

COMMISSIONER GIBSON: Essentially, they have got a lot of home-work to do?

MR. THOMAS: A lot of home-work. The correspondence is circulated among every board member. He has a pile of stuff on his desk every day depending on how much he wants to go into the background of a particular question. As the Board functions, at a meeting of the Board they will have first a list of letters that has been circulated and that every Board member has initialled and they are formally approved at that meeting. The Chairman will say "If there is no objection it is approved." However, on occasion some Board members may raise questions: Typical items are whether this bank should have a branch somewhere, a letter to a Congressman or a letter to somebody raising a question of policy or something of the sort. Then, presumably having cleared all the previously circulated correspondence, there will be

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COMMISSIONER GIBSON: Most of the same things go over each governor's desk as go over the chairman's desk?

MR. THOMAS: Yes.

COMMISSIONER GIBSON: So they have basically all the same information?

MR. THOMAS: That is right.

COMMISSIONER GIBSON: Do they do much travelling and explaining of policies to the bankers in the local reserve banks?

MR. THOMAS: Yes, quite a lot. They attend meetings of the boards of directors of Reserve Banks. They attend bankers' association meetings and various meetings. Some board member is always making a speech somewhere or other. That is the advantage of having seven board members, that you can always get a quorum and still have an opportunity for the others to get around the country. They also do a certain amount of travelling abroad: It is done now with the monthly meetings of the Banks for International Settlements, there is nearly always a representative of the Federal Reserve bank in New York -- a senior officer -- and more often than not now either some staff member or some board member will attend various of the meetings. When they do that they also visit other central

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COMMISSIONER GIBSON: The senior staff don't really have a boss in the board of governors?

MR. THOMAS: No.

COMMISSIONER GIBSON: They report to the governors?

MR. THOMAS: Formally the chairman is responsible for the senior staff -- yes, the senior staff report to all the governors.

COMMISSIONER BROWN: Directly? There is no secretary?

MR. THOMAS: There is a secretary, but he is a member of the senior staff too. We don't consider the secretary has any powers over any other division except purely the routing of material and seeing that the job gets done; but material is assigned to a division, and a division head is responsible for that.

COMMISSIONER GIBSON: How do you make sure that the various governors of the system make reasonably similar pronouncements on monetary values? In other words, do the staff prepare their speeches?

MR. THOMAS: The speeches are generally pretty carefully gone over. We have one official who is assistant to the board who is our press relations man, and generally all speeches delivered are read by him beforehand. Basically, in the final analysis it is up to the individual responsibility of the board member.

THE CHAIRMAN: If the public relations man disapproves of a portion of his speech, he is not bound by that?

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COMMISSIONER BROWN: You mentioned that correspondence is circulated before the governors, but there is no circulation of speeches prior to the delivery.

MR. THOMAS: If they want to, but most governors would just as soon be relieved of the responsibility of reading somebody else's speech. However, sometimes they do. They will say, "I wish you would look this over and see what you think about it." However, they know pretty well about what they

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COMMISSIONER BROWN: I notice in your paper the appointed term is 14 years for the governor, and at the same time there have been 10 new appointments in the last 10 years. Is there a retirement age, or what has caused these vacancies?

MR. THOMAS: No retirement age, but some resignations, and deaths. In a period of 10 years you would normally have five vacancies, and there have been some re-appointments. If a man is appointed to fill out an unexpired term he can be re-appointed to fill out an unexpired term he can be re-appointed for another full 14-year term. We had one board member who was there 26 years under the 14-year rule. He was originally appointed for a 12-year term, and then a 14-year term. It happened he had also served before the law was changed, for four years. So, altogether he served nearly 30 years.

COMMISSIONER BROWN: Are there any retirement ages for directors of the other Federal Reserve banks?

MR. THOMAS: The staff?

COMMISSIONER BROWN: The staff.

MR. THOMAS: Well, for the staff of the Federal Reserve banks -- the retirement age is 65, but the president may finish out his term if he wants to: Some do and some don't. Some stay a few years after 65, but most of them have generally retired around that age.

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MR. THOMAS: Theoretically he could be, yes. There is no age limit on the Board of Governors except at the discretion of the President of the United States who appoints the members of the Board of Governors.

COMMISSIONER BROWN: Latterly he seems to have been going, more than formerly, to people who have previous experience within the system?

MR. THOMAS: I think a little bit -- directors maybe, but not necessarily officers.

COMMISSIONER LEMAN: In a slightly different field, are there institutions in the United States, as there are in Canada, that have what we call chequable deposits, although the non-banking institutions in Canada that have them have to deny what is drawn is a cheque, because it is a legal problem?

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Nevertheless they have these demand orders drawn on them. Are there such things in the States?

MR. THOMAS: I think no. I think it would be illegal.

COMMISSIONER LEMAN: You believe it would be illegal in the States. Nevertheless, has there ever been discussions or suggestions in the States that the Federal Reserve banks should operate a clearing system?

MR. THOMAS: The Federal Reserve banks do operate a clearing system for cheques. Member banks deposit their cheques and they are cleared through the Federal Reserve system. Cheques on local banks are generally not deposited at the Federal Reserve bank. The clearing house clears this, and the Federal Reserve is one of the members of the clearing house for cheques on local banks which can be cleared immediately. However, cheques on out-of-town banks can be deposited in the Federal Reserve bank. Generally most of them operate on a 24-hour basis. Their transit department. I started my career in the Federal Reserve system in the transit department of a Federal Reserve bank in Philadelphia working from one at night until nine in the morning. Most of them do have these departments that work on a 24-hour basis. Maybe all of them do. There are some large correspondent banks which prefer what we call direct sending and do not clear through the Reserve Banks. They would operate their own clearing system and send directly out to the banks. They send only the ones to the Federal Reserve Bank which would be too expensive for them to handle.

Nevertheless they have these demand orders drawn on them. Are there such things in the States?

MR. THOMAS: I think no. I think it would be illegal.

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COMMISSIONER LEMAN: It is not a matter of law, but a matter of convenience?

MR. THOMAS: Yes. All Federal Reserve banks are prohibited by law from paying exchange on any cheque that is deposited with them. If a cheque is deposited with them and they present it to the bank for collection the Federal Reserve Banks cannot pay exchange for cashing that cheque. There are some non-member banks which charge exchange. Those cheques cannot be cleared through the Federal Reserve system.

COMMISSIONER LEMAN: So is this a free service to the banks by the Federal Reserve system?

MR. THOMAS: Yes, there is no charge. In fact, that is the whole principle of it, namely, cheques represent an important part of the monetary system of the country and should be done with a minimum of cost to the public.

COMMISSIONER LEMAN: But offsetting it is the lack of immediate credit to the customer?

MR. THOMAS: There is a schedule on credit in respect of cheques that are deposited in the Reserve Banks. The Federal Reserve will give immediate credit for anything that is within the immediate community, or rather one-day credit. A deposit one day will be credited the next day unless there is a special arrangement for immediate credit, for instance, if they are dealing in federal funds. They give one-day credit on items that are within the one-day range of the Reserve Bank and two-day credit on some other items, and three-day on some others. We used to have

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it as long as seven days on some, but with aeroplanes they can now be cleared more quickly.

They are all not cleared within that time, and that builds up what we call a Federal Reserve float, where a bank actually receives credit for a cheque it has deposited before the Federal Reserve banks get paid for that cheque. It is a widely fluctuating item but it is an item that we take into consideration when figuring the availability of reserves and adjusting our open market operations accordingly.

COMMISSIONER LEMAN: Well, now, in a slightly different phase of the subject, your paper explains in respect of mergers and various ventures that the banks might want to get into, that member banks are subject to the approval of your Federal Reserve.

MR. THOMAS: I stated that. I do not think I explained it.

COMMISSIONER LEMAN: You stated it here.

MR. THOMAS: Yes. That would be another very big paper if I tried to explain all of it. It is a very involved legal problem.

COMMISSIONER LEMAN: I wanted to ask you a rather general question about this idea. In the United States a lot of banks perform trust functions at the same time, whereas up here in Canada that is a separate operation. Outside of the strict banking system are there any other restrictions on banks in the States in respect to owning other types of institutions, or taking a major interest in them and that sort of thing?

MR. THOMAS: Oh, there are very strict regulations about bank affiliates as developed in the Bank Act of 1933. B nks are exceedingly restricted in the extent to which they can own other institutions, particularly financial institutions. That all grew out of a great many problems that developed in the 1920's when banks had security affiliates. Those are now prohibited. Banks can have no interest in another financial institution.

Now, the way the laws are drawn and the legal technicalities I do not feel qualified to discuss, but one of the things that does take a lot of the Board's time is in regulating some of these institutional relationships. Some of them are absolutely prohibited but some are permitted under certain conditions. They are pretty restrictive.

COMMISSIONER LEMAN: Are these restrictions embodied in legislation outside of the main Federal Reserve Act? Is there all kinds of other legislation that has been introduced?

MR. THOMAS: Some of them are amendments to the Federal Reserve Act. Some of them are amendments to the Federal Deposits Insurance Corporation Act; some of them are amendments to the Securities and Exchange Act.

COMMISSIONER LEMAN: But more than one of them has remained of interest in this matter?

MR. THOMAS: Oh, yes, there are over-lapping jurisdictions. I have here the Federal Reserve Act, and it has an appendix containing provisions of the

other statutes.

COMMISSIONER LEMAN: I think a general statement would suffice, Mr. Thomas. We have access to those documents.

MR. THOMAS: There are a great many other statutes here; the Bank Holding Company Act and various others.

COMMISSIONER LEMAN: But you feel that it is proper to say that the general conclusion is that all this compendium of laws tends to restrict banks strictly to the banking field?

MR. THOMAS: That is right.

COMMISSIONER HARROLD: Perhaps I could ask one question. Do you have a clear definition of what a bank is in the United States?

MR. THOMAS: Yes, I think so now. I think it is an institution that accepts deposits. I don't know whether this involves accepting them for chequing purposes, or whether it includes savings deposits. I do not think there was a clear definition until 1933 but I believe there is now. It used to be that brokers and dealers in securities had deposit accounts on which one could draw cheques. They still have a certain amount of customers' deposit accounts they call free credit balances, but they are supposed to arise entirely out of the business of buying and selling securities.

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THE CHAIRMAN: That is a statutory definition?

MR. THOMAS: A statutory definition, I think.

COMMISSIONER GIBSON: Mr. Chairman, Mr. Thomas has made some very interesting comments about the international payment system and some of the problems associated with it. I take it from your remarks that you feel that there is enough international liquidity if we use it better; enough international reserves if we can manage to use them more effectively?

MR. THOMAS: I think there are adequate facilities for the making available any international reserves that might be needed. I think there may be need, and no doubt is need, for more changes in the arrangements for doing that, and some changes in the practices, maybe at some time in the future. For instance, we still have to complete arrangements to increase the facilities of the International Monetary Fund for this purpose. I think it could be said that there is need for a considerable amount of international liquidity, and particularly as the convertibility of currency increases. As the international money market becomes broader and more integrated there is likely to be more movement of funds around the world, just as in our own situation we have movements of funds from one region to another.

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I remember my father, who was a country banker, talking about the time when he would have

to pay exchange on Detroit, Chicago, Minneapolis or St. Louis, or some other districts. When the Federal Reserve system was organized to provide facilities for clearing these movements through the banking system, the needs for differences in exchange rates disappeared. Maybe we are moving toward that sort of a system throughout the world where there will be movement of funds from one money market to another in response to changes in interest rates, as well as in response to the other basic factors which effect the balance of payments. We have to recognize the need for a larger volume of international monetary transactions which will require a certain amount of liquidity. Again, that can be worked out by arrangement within the financial structure between central banks and between private banks. To some extent we ought to be able to clear these without too much strain on the economy, provided we can get assurances of currency stability.

The risk of a change in the value of the currency creates uncertainties and can cause movements which are based upon no necessary need for the shifting of funds or even a reflection of interest rate differentials, but are done merely from fear or expectation that some rate of exchange might be varied.

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used for international purposes. It may be that there will be other currencies that will be used for that purpose; Swiss francs to some limited extent from the standpoint of volume, but a relatively large extent from the standpoint of receiving funds. It is very important that these currencies always be maintained, or at least that there be assurances that their value will be maintained and not changed, otherwise our whole mechanism of international payments will break down, and we will have to go through a long period of exceeding difficulty.

I think the extent to which we can get that assurance, liquidity needs would be less than they would be in a situation where there could not be such assurances.

COMMISSIONER GIBSON: You have made one statement to the effect that no standard will work in the long run unless all the major central banks agree to forego once and for all in favour of keeping all their reserves in the form of gold. Do you think there is enough gold around?

MR. THOMAS: There is not enough gold to go around if everybody wants to keep all their reserves in the form of gold just as there would not be enough gold in the United States if we permitted every member bank to hold all its reserves in the form of gold. There is not enough gold to perform the monetary functions of the world if every individual could hold gold at any time he wanted it.

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type of international money. If it could be limited to that use I think there is plenty of gold, but that still means central banks would probably find it necessary to maintain a certain amount of balance with each other, so that some of these adjustments could be made without the necessity of changing the ownership of gold. Just as in the United States, most of our inter-bank transactions are made through inter-bank balances. Your transactions are made within your branch banking system, but if every time you had a shift of funds from one region to another you had to have a movement of gold there would not be enough gold for that purpose. We can, by improving the efficiency of our clearing mechanism, I am sure, operate with what gold we have and the gold that may be provided through increased production in the course of time.

COMMISSIONER GIBSON: I understand that you do not think much of the idea of raising the price of gold in order to provide more international liquidity?

MR. THOMAS: No, I have more confidence in the ability of central banks to create more money without doing it by that device.

Our problem does not involve the ability to create money, but to create it in the way that it moves to the right places at the right time. Changing the price of gold only benefits those that happen to have gold, particularly the Russians and

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South Africans. Most of the benefits go to those that already have a lot of gold and do not help those that do not have any. So, there are other ways of providing international liquidity, and providing also for its redistribution which are far more equitable than by changing the price of gold. The very risk of changing the price of gold is something that discourages more efficient use of gold as an international reserve mechanism, because it encourages people to hoard gold in private supplies and remove it from the international reserve stock in order to take advantage of the possibility that the price of gold might be raised. There are only a few occasions in history where the price of gold has been lowered, one being the occasion when the Germans and the Dutch did it last year. Generally the expectation is that gold will rise in price.

COMMISSIONER GIBSON: It happened once in Canada.

MR. THOMAS: Yes, I guess maybe it did.

COMMISSIONER LEMAN: Well, that is a long term view, Mr. Thomas; as the functioning of markets and facilities for moving funds across international borders is developed and made smoother and easier, as you have just described it.

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Do you see some day the need or the possibility of some kind of a super-body that would exercise the type of monetary control, world-wide, as there is in each country and to effect the general liquidity all over the whole system instead of just in one particular country?

MR. THOMAS: There may be, but there are a lot of things that have to be done before that; there is the question of sovereignty to tax systems and you have to move a long way in that direction on international uniformity of practice before we can count on a universal monetary system, but I think we are moving in that direction. It may be it will never be necessary to have an over-all institution or lender of last resort. It might be desirable at some time, but I should say it is at least a decade away.

COMMISSIONER GIBSON: Do you think flexible exchange rates are an appropriate instrument of policy, monetary policy, in some countries? I am not asking this question in relation to the United States, but we have such a policy here in Canada.

MR. THOMAS: No, I don't like flexible exchange rates, as a personal view. I think it is much better to have the adjustments that are necessary to be made through the individual prices and costs rather than through trying to change the whole structure of your price level, including things that may not need to be changed.

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uncertainties and they make necessary adjustments that would be unnecessary otherwise. If they possibly can be avoided they should be. This is not saying at times certain countries have to change their exchange rates when they get far out of line, but even this I think could be avoided if they followed the right policies first. Generally changes in exchange rates are necessary because they have been following the wrong policies before that, and that should be avoided.

COMMISSIONER MACKINTOSH: Might it be that some of the major reserve countries have been following policies that make life difficult for the others?

MR. THOMAS: Yes, they may be.

COMMISSIONER BROWN: Do you care to comment on the extent to which fixed exchange rates prevent certain flexibilities in monetary policy?

MR. THOMAS: I don't think they prevent flexibilities in monetary policy, no. I don't know why there should be varying exchange rates between one country and another any more than there should be between New York and San Francisco say.

COMMISSIONER BROWN: I think it has been said here in Canada that we have great difficulty at times in maintaining a rate that might have been appropriate a little earlier, because of the terrific size of capital flows between here and the United States, and this is a rather unusual situation.

MR. THOMAS: Yes. I would prefer to see these adjustments made through the interest rate

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structure, but I am not sure it is feasible.

You see, you have a policy in Canada of, in effect, sterilizing foreign exchange movements so they don't affect your interest rate structure, in that all the foreign exchange that comes in is bought by the Exchange Equalization Account and the funds are held abroad, so they don't enter into your monetary stream. This is balanced out by public debt operations.

Now, we do it differently in that the gold that comes in is bought by the Treasury and is immediately converted into money by transferring gold certificate credits to the Federal Treasury in effect creating the money to buy the gold with, and that enters into our supply of member bank reserves. Whether the Federal Reserve offsets the effect of that by selling securities in the market is a matter of policy. If it is offset by Federal selling or buying of securities rather than by treasury selling or buying of securities, it can end with exactly the same effect, but it doesn't necessarily do it. It becomes more a monetary policy decision.

COMMISSIONER MACKINTOSH: Only the marginal power for exchange purchases and sales affects the exchange fund?

MR. THOMAS: That is right, but it is the margin I am talking about.

COMMISSIONER MACKINTOSH: It doesn't even follow that -- well, with a fixed rate I suppose they have to take it at an increase?

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COMMISSIONER MACKINTOSH: Unless it is offset by the market?

MR. THOMAS: That is right.

COMMISSIONER MACKINTOSH: Would you suggest it would be better to allow these movements to have their full and immediate effect?

MR. THOMAS: No, I think you have to relate it to the monetary requirements of the domestic economy and with due regard to the international situation, but there are times when it might be advisable to permit them to have the effect in order to avoid undue influence. It could be done through the interest rate structure.

COMMISSIONER BROWN: I am not quite sure how this will operate when you have large flows of capital in that are not affected by the interest rate structure but where they are for investment in equity or ownership in real estate.

MR. THOMAS: Of course, according to the old gold standard rules when capital comes in it is supposed to enter into the banking and monetary system and affect domestic interest rates or stimulate domestic buying activity and affect domestic prices and you get the adjustment.

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COMMISSIONER GIBSON: Mr. Chairman, if there are no more questions along this line, I wonder if Mr. Thomas might make one other brief statement. He has told us during this very interesting discussion quite a little about the report of the Monetary Commission in the United States in relation to a number of recommendations.

Now, I wonder if he would care to say a word or two on what he thinks of the other well known report that has come out in the last few years, that of the Radcliffe Committee on Great Britain, from the standpoint of the American monetary system?

MR. THOMAS: It is of course difficult to relate the report that is made on the basis of experience in one country to the situation in another country, but perhaps one of the significant aspects of the differences between the Radcliffe Commission

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report and the report of our Commission on Money and Credit, or the actual operating procedures that are used in the United States, is to bring out to some extent the differences that exist between those countries.

I have some notes here where I have given some thought to this at one time in the future. The Radcliffe report had the result of stimulating discussion on monetary policy and mechanisms and effects in academic circles, among market practitioners and among policy-makers in both the United Kingdom and the United States and elsewhere.

This report is related primarily to British practices, but since then we have had the Commission on Money and Credit study in the United States and its report, which gives an opportunity to compare or contrast the American practice and views.

Also, the recent financial developments in the United States throw a light on how these procedures and theories have actually worked out under varying conditions.

The Radcliffe Committee's principal policy views, in effect, seem to -- and I would emphasize "seem to" because this is my interpretation and I am not trying to speak on anybody else's behalf, particularly not for the members of the Commission -- they seem to reject the control of cash reserves of banks as a means of regulating the money supply.

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it is based on the actual practice of the Bank of England of always buying treasury bills at a price -- if they do that -- that prevents the contol of cash reserves.

The second point is that the report seems to minimize the influence of money supply on interest rates and on spending, and emphasizes general liquidity as the principal monetary influence on aggregate spending and on the maintenance of economic growth and stability. But, because of the wide range of financial institutions that supply credit in Great Britain, the difficulties of controlling general liquidity creates problems which the report recognizes but I am not sure provides any answer to.

The report rejects the Bank of England control of short-term interest rates as an effective means of regulating the economy through monetary measures. You see, they have rejected the control of cash reserves as a means, because the Bank of England will buy bills at some rate and then they turn around and also reject the control of the economy or the money system through the variations in the interest rates.

The report recognizes that relatively large changes in the level and particularly in the structure of interest rates may have an effect on spending, and it indicates that the authorities should have a positive policy towards interest rates, but they again are not too clear as to how this should be done. They furthermore seem to believe that the effects of any interest rate policy are slow or that wide fluctuations would be harmful, so we must leave it in the air as to what is the means of control that they would use.

They do place great emphasis or reliance on debt management and fiscal policy as a means of influencing general liquidity and the structure of interest rates and they also give some support to the use of direct or selective controls on particular lending activities of financial institutions, but at the same time recognize the difficulties and disadvantages of such an approach and it would be used only as a last resort.

In effect, it seems to me that the Radcliffe Committee's recommendations leave the function of monetary policy consideration uncertain and provides no guides or standards as to how those policies should be conducted.

The U.S. monetary policy in contrast, has set forth in the Federal Reserve board's submission to the Commission on money and credit -- which has not yet been published and which I have used extensively in my presentation here -- and also to a considerable

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extent in the C.M.C. report, and assigns a more positive and definite -- though still limited -- role to monetary policy

First, they place primary emphasis on the control of cash reserves of banks and the resulting regulation of the money supply. These are the particular magnitudes that the Federal Reserves can fairly effectively control.

Secondly, they recognize the importance of other liquid assets and non-bank financial institutions in supplying liquidity and credit, but point out that these facilities need not unduly hamper the effectiveness of monetary policy. Regulation of the money supply can influence total liquidity and, moreover, monetary regulation can, should be and has been adjusted to take into consideration changes in general liquidity and in the activities of non-bank financial institutions.

Third, as to interest rates, interest rates are affected, directly and indirectly, by monetary policy actions, and have an influence on the economic decisions. Interest rates, however, are also influenced by the various other decisions beyond the control of monetary policies, and in the longer run are likely to be determined by such decisions. It is essential for a proper functioning market economy that interest rates be permitted to fluctuate both as to level and structure. Market fluctuations in interest rates reflect the impact of general liquidity and the activities of the various

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financial institutions, and it is largely through interest rates that these non-bank activities may be influenced by monetary policy.

Fourth, public debt management also has an influence on the structure of interest rates -- and fiscal policy on the level of rates -- but under existing allocation of powers in the United States these are not the responsibility of the Federal Reserve. They must be taken as given in the determination of monetary policies and monetary actions must be adjusted accordingly so as to support the broad objectives of monetary policy and not the transitory problems of debt management -- except for very brief periods.

These differences in approach in the conduct of monetary regulation are illustrated by the developments in the United States in the last two or three years.

1959 is illustrative of a period in which aggregate credit demands were tremendous including a record federal budget deficit and in which most of these demands were met from non-bank lending sources.

The amount of credit supply was large while the capacity for expanding output was restricted by the steel strike.

Monetary policy was successfully directed toward restraining bank credit and monetary expansion.

Interest rates rose sharply, thus helping to bring in funds from non-bank lenders.

Commodity prices were remarkably stable.

The developments of this period do not represent a failure of monetary policy to deal with a situation characterized by a great deal of non-bank lending, but rather the success of monetary policy in

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The restrictive policy no doubt prevented development of an inflationary trend and thus the avoidance of a serious subsequent collapse.

Whether the policy continued too restrictive too long may be debatable, but any such judgment would be based on hindsight rather than on the facts available at the time.

1961, to take another period, illustrates a situation of easy money policy along with economic recovery from recession which occurred with little monetary expansion as narrowly defined to include expansion of demand deposits and currency -- but with a very marked expansion in liquid assets.

Reserves were fairly generously supplied to banks and total bank credit expanded at a pace that was stimulative for the economy.

An increase occurred in time deposits at commercial banks as well as in other types of fixed-value redeemable claims in financial institutions.

Debt management and the fiscal situation added to the public debt and particularly to short-term securities.

These additions were reflected in bank, rather than in non-bank holdings.

In 1961 the banks bought short-term government securities, thereby supplying funds to the public. The banks had the available reserves for increasing their holdings of government securities. The public didn't buy

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A possible explanation of this combination of events lies in moderate degree of the interest rate decline -- much less than in other recession periods. It is partly a result of the policy in holding up or refraining from reducing short-term rates in order not to encourage a flow of funds abroad and the loss of gold reserves. There was in this period a positive policy toward interest rates, to use the words of the Radcliffe Commission.

The view that short rates could be kept up and long rates lowered which was held in some circles proved to be unworkable.

Other factors keeping interest rates up were the moderate nature of the recession that had occurred, and the maintenance of borrowing demands, particularly long-term, at fairly high levels.

Again, though, the money supply did not increase as much as might have been considered desirable although the monetary policy cannot be said to have fallen down.

General liquidity increased and credit was freely available. Actually, the total increase in all types of credit in 1961 was about $50 billion -- more than in any other year except 1958. Bank credit increased about $16 billion which was only a little less than it was in 1958. This increase was about 7 per cent, which was roughly commensurate with the increase in Gross National Product which was about 8 per cent.

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Recovery advanced in 1961 about as fast as could be expected and a vulnerable bond market was avoided in contrast to the year 1958.

Looking briefly at 1962, the same credit trends that characterized 1961 have continued with even more striking increase in time deposits at banks which has been stimulated by the increase in interest rates paid by banks.

There has been some, though still moderate, increase in demand deposits and currency. In both years there has been an increase in demand deposit turn-over.

In 1962 we might say the economic activity increase has been slower than desired, but the slowness evidently cannot be attributed to the lack of credit availability. Other factors of a structural nature must be the cause of this slow rate of economic expansion and the continued slack in the economy.

Mr. Chairman, that more or less summarizes the position that I have tried to present to this Commission in my appearance before you.

THE CHAIRMAN: Mr. Thomas, I wish to thank you very much indeed for not only the brief you have presented but for the most comprehensive discussion in which we became involved in the last two days. It has been invaluable to us in our deliberations and we are very greatly indebted to you for your contribution to the work of this Commission.

We wish to thank you and also the board of governors of the Federal Reserve system for helping

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to make your appearance possible.

MR. THOMAS: Mr. Chairman, it has been a great privilege to me to be able to end my career in central banking by appearing here to present the views from my experience and the philosophy that I have developed as well as to endeavour to present the general views and principles that govern the Federal Reserve system in its operations.

THE CHAIRMAN: This session will now adjourn and the Commission will meet on Monday, September 10th, in Ottawa at 9:15 a.m. when we shall hear the submission of Lord Cobbold, formerly the Governor of the Bank of England.

---ADJOURNMENT.

Royal Commission on Banking and Finance

WOODLIEF THOMAS

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OPERATION OF THE MONETARY SYSTEM
IN THE U.S.A.

Memorandum Submitted at the Request of the
Royal Commission on Banking and Finance
Ottawa, Canada

by

Woodlief Thomas, Adviser to the
Board of Governors of the Federal Reserve System
Washington, D.C., U.S.A.

May, 1962

OPERATION OF THE MONETARY SYSTEM IN THE U.S.A.

SUMMARY

Monetary and credit institutions and practices in the United States differ from those in Canada in a number of significant respects. The more fundamental of these differences fall into two broad categories; (a) structural features that cannot easily be changed, and (b) procedures that have become well established but might be altered. Many of the variations in operating practices as between the two countries stem from these more or less ingrained differences. Others are the result of differences in situations that arise or in judgment.

Structural features - Principal differences of a basic structural nature are:

(1) In contrast to the Canadian system of a few large banks with widespread branches, operating mostly under a single jurisdiction, the banking system in the United States consist of thousands of individual banks, operating under separate laws -- State and Federal; supervised by separate and overlapping authorities; and with branches either prohibited or confined to limited areas. An important result of these differences in the United States is to increase the over-all liquidity needs of the banks with frequent demands for Reserve Bank credit, and to promote the existence of an active short-term money market to allow for shifts of funds among banks.

(2) The organization and procedures of the

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(2) The organization and procedures of the

central banks differ. The Federal Reserve System is a complex structure of 12 separate Federal Reserve Banks and a Board of Governors in Washington, with a Federal Open Market Committee consisting of members of the Board and five representatives of the Federal Reserve Banks. Although authority for policy decisions is divided among these bodies, most policies are formulated on the basis of joint participation and discussion at the frequent meetings of the Federal Open Market Committee. This gives the benefit of wisdom and knowledge of many informed and responsible people.

(3) In its relationship to the current governmental administration, the Federal Reserve System has a recognized status of independence. This is partly the result of the constitutional structure of government in the United States with division of powers between Congress and the President. Congress has allocated the administration of the monetary power to the Federal Reserve. This independence of the Federal Reserve System within Government may also be said to reflect the view, which underlies the establishment of separate central banks in most countries, that authority to regulate the creation of money has to be safeguarded against abuse either by Government or by private enterprise, though not completely divorced from influence by either.

<u>Procedural differences</u> - Principal differences between well established procedures in the monetary and credit systems of Canada and the United States are:

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commercial banks is more complex and perhaps more rigidly enforced in the United States. There are different requirements for demand and time deposits and for demand deposits in two classes of banks. These differences are due in part to historical developments, but they also reflect the basic principle that the various categories of deposits have differing degrees of money quality.

Because individual member banks find somewhat more occasion to borrow at the Reserve Banks, the act of borrowing and the discount rates charged have more impact and probably greater significance in the United States than in Canada.

In the United States, banks are prohibited from paying interest on demand deposits, and maxima are imposed by regulation on rates that may be paid on time deposits. These maxima vary according to term of the deposit and are changed from time to time. These restrictions were imposed initially to safeguard banks against unsound competitive practices and to reduce the attraction of funds to financial centers. They also have some impact on the allocation and perhaps the volume of saving.

Although the Federal Reserve Banks serve as fiscal agents for the Treasury in holding balances and in executing transactions involved in management of the public debt, as well as in other fiscal operations, it appears that the Bank of Canada is more active and exercises a higher degree of responsibility for decisions in public debt management than do the Federal Reserve Banks.

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Another significant difference in debt management procedures is found in the use of so-called tax and loan accounts at commercial banks as an effective means of underwriting Treasury issues of new securities. This process removes or reduces the necessity for using Reserve Bank credit in these operations in a way that might conflict with current monetary policy.

Monetary policies in Canada and the United States may also be differently influenced by the positions with respect to international movements of funds. These arise from differences in factors affecting the balance of payments and also from the status of the U.S. dollar as an international reserve currency.

Objectives of monetary policy - Broad objectives of monetary policy are generally identical in nearly every country. They are to assure availability of sufficient bank credit and money for sustained economic growth and development; to maintain stability in the general level of prices; and to protect international convertibility of the currency. It is also an aim of Federal Reserve policy in achieving these objectives to maintain the operation of free markets in a free enterprise system.

Processes and procedures through which policy is executed are necessarily more specific than these broad goals but can never be dissociated from them. Procedures used in one country differ in many respects from those followed in other countries. In summarizing a comprehensive answer recently submitted to questions

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[illegible]

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by the Commission on Money and Credit, the Board of Governors described the focus of Federal Reserve operations, as follows:

"Federal Reserve policies, directed toward the broad ultimate objectives of fostering price stability, high level employment, and sustained economic growth, are determined by the policy-making authorities of the System on the basis of a great many considerations. They are put into effect operationally through control over bank reserves. It is principally through the channel of bank reserves that Federal Reserve policies influence the volume of bank credit, the money supply, and interest rates."

Instruments of Federal Reserve policy -- Principal instruments employed by the Federal Reserve to influence the availability of bank reserves include the following:

(1) Discounts (member bank borrowing) at the Reserve Banks make reserves available at the initiative of the banks, but in a manner that exerts restraint on credit expansion, because of a well-established tradition against borrowing. The degree of restraint may be varied by alterations in discount rates and to some extent by Reserve Bank administration of the discount facility.

(2) Open market operations, which are conducted at the initiative of the Federal Reserve Open Market Committee, affect the availability of reserves for banks in general. These operations comprise the bulk of

[illegible]

[illegible]

[illegible]

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(2) Open market operations [illegible] are conducted at the initiative of the Federal Reserve [illegible]

[illegible]

Federal Reserve credit activities, but most transactions are engaged in for the purpose of offsetting large seasonal and other temporary fluctuations in various other factors, such as currency and gold movements and float, that affect the supply of reserves.

(3) Changes in reserve requirements of member banks, which may be made within specific limits by action of the Board of Governors, can affect the availability of reserves without changing the existing supply. This instrument is not suitable for use in delicate adjustments of reserve availability and is employed generally only for making major alterations of a longer-term nature.

Except for control of stock market credit, which for historical reasons had come to occupy an excessively unstabilizing role in the U.S. credit structure, the Federal Reserve has made little use of attempts to regulate specific types of credit by selective controls or by methods of persuasion. Such measures not only have the disadvantage of interfering with free market processes but also are difficult to apply in the United States with its large number of banks and other credit institutions.

Guides to and effectiveness of Federal Reserve actions - Particular considerations that influence the determination of Federal Reserve policies and actions and the developments that measure the effectiveness of such actions are numerous and broad. The primary guide is the reserve position of banks. The various considerations that are kept in mind have

[illegible]

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been summarized by the Board in its answers to the Commission on Money and Credit as follows:

"In determining the volume of operations needed at any time in order to provide reserves adequate for changes in bank credit and the money supply that would best contribute to the broad objectives of policy, allowance must be made for seasonal and other temporary variations in factors that affect the supply of or demand for reserves. In dollar amounts these temporary variations are much greater than cyclical or growth needs.

"Decision as to the appropriate amount of bank credit and money at any time is made in the light of a great number of variables: supply and demand conditions in markets for goods and services, and volume of employment and production relative to available resources, movement of the general level of prices, the general liquidity of the economy, the availability of credit from nonbank sources, the strength of prevailing credit demands, and the rate at which the existing money supply is being used. It must be recognized that bank credit supplies only a relatively small portion of the total credit needs of the economy, but the maintenance of this portion at an appropriate amount is of considerable marginal importance in helping to make possible sustainable economic growth.

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"In determining the volume of operations needed at any time in order to provide reserves adequate for changes in bank credit and the money supply that would best contribute to the broad objectives of policy, allowance must be made for seasonal and other temporary variations in factors that affect the supply of or demand for reserves. In certain months, these temporary variations are much greater than cyclical or growth needs.

"Decisions as to the appropriate amounts of bank credit and money at any time are made in the light of a great number of considerations. Supply and demand conditions in markets for goods and services, and trends of employment and productivity relative to available resources, movements of the general level of prices, the general liquidity of the economy, the availability of credit from nonbank sources, the strength of investment demands, and the rate at which the existing money supply is being used. It must be recognized that bank credit supplies only a relatively small portion of the total credit needs of the economy, but the maintenance of this portion at an appropriate amount is of considerable weight, of importance in helping to meet various

"Movements of interest rates are determined by the interaction of borrowing demands of all kinds upon the available supply of lendable funds. Bank credit is only a portion of this supply. Federal Reserve policies and operations do not aim at long-term control of the level or structure of interest rates. Normally the free interplay of supply and demand forces on the course of interest rates enables such rates to perform essential allocative functions. Interest rate changes are an essential part of the mechanism through which monetary policies ultimately influence the decisions of borrowers and lenders. They serve as a significant indicator of market developments that are relevant to the determination of such policies."

Formulation and execution of monetary policy is a continuous process. Continuing review and appraisal of economic and financial developments is a prime essential. Specific actions by the Federal Reserve affect the supply of bank reserves and through them the availability of bank credit and the supply of money. The impact of Federal Reserve policies upon the greater volume of credit that is obtained from nonbank sources, upon the general liquidity of the economy, and upon the level and the structure of interest rates is indirect and often quite remote. Developments in all of these areas, however, are taken into consideration in formulating Federal Reserve policy decisions.

Movements of interest

by the interaction of borrowing demands of all

[illegible]

Bank credit is only a portion of this supply. Federal Reserve policies and operations do not aim at long-term control of the level or structure of interest rates. Normally the free interplay of supply and demand forces on the course of interest rates enables such rates to perform an essential allocative function. Interest rate changes are an essential part of the mechanism through which monetary policies ultimately influence the decisions of borrowers and lenders. They serve as a significant indicator of market developments that are relevant to the determination of such policies.

Formulation and execution of monetary policy is a continuous process. Continuing review and appraisal of economic and financial developments is a prime essential. Specific actions by the Federal Reserve affect the supply of bank reserves and through them the availability of bank credit and the supply of money. The impact of Federal Reserve policies upon the general volume of credit must be obtained from numerous sources, upon the general liquidity of the economy, and upon the level and the structure of interest rates [illegible]

In all of these areas, however, are taken into consideration in formulating Federal Reserve policy decisions.

Federal Reserve authorities also are constantly aware and are alert to point out that monetary policy should not and cannot be relied upon to assure the maintenance of an appropriate level of aggregate demand or of any particular element of consumption or investment, except to the extent that adjustment in available cash balances can contribute to such an objective. Aggregate demand and economic equilibrium depend more largely on productivity, on the structure of prices and costs, on the distribution of incomes, and on various other incentives, than on variations in the quantity of money. Monetary policies cannot be expected to prevent or correct imbalances that might result from structural imperfections or from mistakes of judgment by business or individuals or by Government. Attempts, in the face of any such situation, to assure continuous stimulation of the economy through bank credit expansion might incur the risk of speculative or other unsustainable developments that would create rather than prevent instability and unemployment.

International considerations in monetary policy

During most of the existence of the Federal Reserve System, contribution to the maintenance of balance in the international payments of the United States and assurance of convertibility of the dollar at a fixed relationship to gold have not been important considerations in the determination of monetary policy. Generally, gold movements were of concern only to the extent that Federal Reserve operations were needed to offset their effect on member bank reserves.

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In recent years, however, persistent deficits in the balance of payments, resulting in drains on the gold stock and continuing through a period of recession in domestic economic activity while activity in other leading countries remained at a high level, has made it necessary to frame monetary policy in a manner that would not encourage further losses of gold reserves. At the same time, because of slack in the U.S. economy, it has been desirable to assure adequate bank reserves to void credit restraint and to promote expansion. This unusual conjuncture of forces has presented a difficult dilemma, especially since some of the principal underlying causes of the payments deficit could not be remedied by monetary policies.

Adjustment in the exchange value of the U.S. dollar is not considered to be a usable means for dealing with this type of problem. In the first place, many of the adjustments needed can be most effectively made through demand, supply, and price changes in particular markets. Attempts to change the general price level relative to others would create other problems of a far-reaching nature. Moreover, because of the role of the U.S. dollar as a key international reserve currency, it is a basic tenet of U.S. monetary administration that the value of the dollar be maintained at a fixed relationship to gold. Any possibility of a change in that relationship would threaten large outflows of funds and loss of gold. In the long run it would destroy an essential means of providing international liquidity.

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In order to assure adequate international reserve liquidity to meet the varying needs of world commerce and finance, it is essential that confidence be maintained in the stability of key reserve currencies. Various proposals for alternative standards or ways of providing the world with additional reserves would not dispose of serious economic and financial problems that underlie recurrent balance of payments difficulties. These will have to be solved by more direct means or through the gradual operation of market processes in particular sectors. Moreover, these proposals do not provide a solution for serious problems in ensuring wide acceptability of some new reserve medium. No standard will work unless major central banks are willing to forego keeping all their reserves in gold.

Organization and personnel of the Federal Reserve System. Organization of the Federal Reserve System consists of the Board of Governors in Washington and the 12 regional Federal Reserve Banks and their 24 branches, which together regulate certain activities of some 6,100 privately owned commercial banks, with a view to regulating the availability of bank credit and of cash balances needed for sustained growth in the economy. This type of organization represents a unique regional concept among the central banks of the world.

The Federal Reserve Board comprises seven members, appointed by the President and confirmed by the Senate, who serve for overlapping terms of 14 years. The law provides for "fair representation of the financial,

agricultural, industrial, and commercial interests and geographic divisions of the country." The Chairman of the Board, selected from the members, is appointed by the President for a four-year term. In selecting men for appointment to the Board, the President has, on some occasions, sought recommendations from the Chairman of the Board and on others has acted on recommendations from other sources. The Board members have been a diverse group, but of appointments made since 1950 a record of some prior service with the Federal Reserve System -- as a director or officer of a Federal Reserve Bank -- has been an important consideration.

The Board's primary responsibilities (as already discussed) include the formulation of appropriate credit and monetary policies to carry out the basic function of the Federal Reserve System. Many of those policies are formulated in cooperation with the Federal Open Market Committee and the Federal Reserve Banks. Its supervisory responsibilities with respect to the Federal Reserve Banks include: approval of the President and First Vice President of each Reserve Bank; review of their annual budgets, including approval of salaries for all officers and employees and of certain other major expenditures; an annual examination to assure compliance with applicable provisions of law and regulation; and coordination of economic research and review of System publications. The Board also directs activities of the System in the examination and supervision of its member banks.

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the Board represents the System in its relations with executive departments and with Congress. It exercises special supervision over the international operations of the Reserve Banks and is represented on the intra-governmental National Advisory Council on International Monetary and Financial Problems.

At the end of 1961 the Federal Reserve System had 6,113 member banks. Of these, 4,513 were national banks, for whom membership is mandatory, and 1,600 were State-chartered banks that had voluntarily joined the System. Less than one-half of all commercial banks in the United States belong, but these hold 85 per cent of the total deposits.

Decentralization is an important characteristic of the Federal Reserve System. Each of the 12 Reserve Banks operates under the general direction of a board of nine directors, who serve three-year terms and who are primarily responsible for the conduct of the banks' affairs, subject to the supervision of the Federal Reserve Board. In a preferential balloting by size of bank, three bankers and three nonbankers are elected to directorships by the member banks in each District. The remaining three are appointed by the Board of Governors and, of these, one is designated as Chairman and another as Deputy Chairman. Those selected for appointment are among the civic, business, professional and educational leaders of the Districts. No director may hold public office of a political nature. The boards of directors select the full-time officers of the Reserve Banks and by far the majority of their top officers are career men

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The directors provide experienced judgment on operational problems, as well as a grass-roots view of economic conditions, and also serve to disseminate better understanding of Federal Reserve policies and actions.

The general reputation and the nonpartisan public character of the Federal Reserve System have been key elements in the recruitment and retention of career personnel. Coordinated efforts of the Reserve Banks and the Board have been directed toward maintaining close contact with colleges and universities throughout the country to facilitate the recruitment of professional personnel, particularly economists.

Comprehensive development and training programs on both an individual and group basis have been fostered throughout the System. Individual training assignments have included attendance at various institutes, seminars, and workshops; visits to Reserve Banks and commercial banks; academic work in connection with graduate degrees; and participation in privately financed fellowship programs. The transfer of personnel within the System also provides opportunities for individual staff training. Group programs for development and training have covered a wide variety of subject matter with special emphasis on economic problems, bank examination, automation, and the use of the electronic computers.

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OPERATION OF THE MONETARY SYSTEM IN THE U.S.A.

1. In viewing monetary and credit arrangements and practices in the United States from the standpoint of possible alterations in the Canadian financial system, it is essential to keep in mind significant differences between the two systems. This memorandum begins, therefore, with a discussion of some of the more important of these differences. The remainder of the memorandum discusses the objectives, guides, procedures, and organization of the Federal Reserve System and its relationship to the Government and to other credit institutions, with little or no reference to the situation in Canada.*

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*This memorandum draws primarily upon two other discussions of the United States monetary system: (1) Answers by the Board of Governors to questions presented to it by the Commission on Money and Credit in its recent inquiry of the American monetary system. These answers, which were prepared in late 1960, are expected to be published in the near future. (2) Memorandum of Evidence submitted by Mr. Winfield Riefler, then Assistant to the Chairman of the Board of Governors of the Federal Reserve System, and also the oral evidence presented in June 1958 by Mr. Riefler to the British Committee on the Working of the Monetary System. Other statements submitted by the Board of Governors to Congressional committees, as well as a variety of published studies and reports, also provide background

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material for some of the statements. In some cases sections have been taken completely or with little alteration, and without reference, from these various documents. The personal judgments of the writer, based upon years of experience with and study of the operation of the monetary system in the United States and to a limited extent systems in other countries, must be held responsible for some of the views expressed. In preparing the section on international considerations, valuable aid was received from Mr. Arthur B. Hersey, Adviser in the Board's Division of International Finance. The section on organization and executive personnel of the System was prepared by Mr. Clarke L. Fauver, Assistant to the Board.

I. Differences Between Financial Systems

2. Aside from differences of magnitude due to population size and volume of national product and diversities in industrial composition as between the United States and Canada, there are two types of more or less inherent or otherwise well-established differences between the financial systems of the two countries: (1) Basic structural features that are inherent for traditional, constitutional, or long-established legislative reasons, which would be difficult if not impossible to alter in either country; and (2) well-established procedures and practices, resulting from legislation or custom, that might be altered through new legislation, regulation, or evolutionary processes.

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Basic Structural Differences in Monetary Systems

3. Principal basic differences of a structural nature, which cannot be easily changed, if at all, significantly influencing the operation of the monetary systems and of monetary policies in the two countries fall into three groups:

4. Banking structure. -- Perhaps the most important is that, in contrast to the Canadian banking structure of a few very large banks with widespread branch systems, the banking structure in the United States consists of nearly 14,000 local banks, operating under a diversity of laws and supervisory authorities. In many States branch offices are not permitted; in others branches are confined to the locality of the head office; and in no case can a bank have operating branches in more than one State.

5. This structural difference is significant from the standpoint of the conduct of monetary policy for a number of reasons. Probably the most important is the effect on the reserve positions of individual banks resulting from clearances among banks, which are much larger in amount with numerous local banks than in the case of a few large, diversified branch bank systems. These adjustments necessitate more frequent resort to Reserve Bank credit and also a greater need for liquidity. These liquidity needs, together with earlier laws as to bank reserve requirements, have led to the maintenance of a substantial volume of interbank balances, which in turn are highly volatile and require the maintenance of liquid positions by the banks in which

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these balances are deposited.

6. All of these liquidity demands depend upon and contribute to the maintenance of a large and active market for demand of short-term money. It is reasonable to conclude, therefore, that the money market, narrowly defined as a market where funds can be readily raised or put to use at some rate of interest for short periods, is necessarily much broader and more pervasive in its influence in the United States than in Canada.

7. Another significant aspect of this complex and diverse banking structure relates to the allocation of responsibility for bank chartering and supervision. This authority resides in the 50 state governments and in three Federal agencies, with a great deal of overlapping. Duplication is avoided or lessened by informal cooperative arrangements. Although the Federal Reserve, which is responsible for monetary policies, has supervisory powers over member banks that are greater than those possessed by the Bank of Canada, the System's authority is shared with that of other agencies and does not cover nonmember banks, except in a few matters.

8. The other two Federal agencies are the Comptroller of the Currency, connected with the Treasury Department, responsible for the chartering and supervision of national banks, and the Federal Deposit Insurance Corporation, which insures the deposits of all national banks, State bank members of the Federal Reserve System, and such other State-chartered banks as

[illegible] are deposited.

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voluntarily become member of the Corporation. There are about 4,500 national banks holding about 55 per cent of the resources of all commercial banks, about 1,600 State bank members of the Federal Reserve System, with about 30 per cent of total banking resources. Nonmember banks number about 7,300, of which all but about 300 are insured.1/

9. Central bank organization. -- The second basic structural difference relates to the respective organizations of the central or reserve banks and the processes of monetary policy formulation. Whereas in Canada there is one central bank, largely operated by its principal officers under general direction of a part-time board of directors, the Federal Reserve Banks, with limited authority to determine monetary policies, and a full-time Board of Governors in Washington with considerable ultimate authority.2/

1/ A brief discussion of bank supervisory functions of the Federal Reserve in relation to those of other bank regulatory agencies may be found in Chapter VIII of "The Federal Reserve System -- Purposes and Functions", published by the Board of Governors, February 1961.

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10. Most important policy decisions are formulated by the Federal Open Market Committee, which is composed of the seven Governors and five Reserve Bank Presidents, four of whom serve on a rotation system for one year at a time. Practically all policy decisions are either determined or discussed at meetings of the Open Market Committee, which are generally held every three weeks and are attended also by Presidents of the Reserve Banks not then serving on the Open Market Committee.

11. This apparently complex and cumbersome structure gives the benefit of the wisdom and knowledge of many informed and responsible people and brings many points of view from all sections of the country into the formulation of monetary policy. Although the processes of decision-making are necessarily somewhat more involved than is the case in a single institution with a titular head in whom most authority is centered, the Federal Reserve structure helps to safeguard against the dominance of any single viewpoint in reaching decisions upon matters so important and at times so far-reaching in their effects as monetary policies. At the same time, with the aid of airplanes and telephones, the benefit of frequent discussions, and continuous interchange of information, decisions can be reached as expeditiously as may be necessary under particular circumstances.

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between the central bank and the general governmental administration. It would be presumptuous and beyond my knowledge for me to attempt to describe the relationship between the Bank of Canada and the Government. From the standpoint of contrast with the United States, a most significant aspect is that Canada has a parliamentary system of government wherein the executive is answerable directly to Parliament.

13. The United States Constitution, by contrast, separates the powers of the executive, controlled by the President, and the legislative, represented by the Congress. The Congress in turn has delegated some of its powers to a number of so-called independent agencies. The power to regulate money, construed to be a particular responsibility of the Congress, has been largely delegated to the Federal Reserve System. In many respects the Federal Reserve is probably more removed from Presidential authority than other independent agencies. It is also administratively removed from the budgetary control of Congressional appropriations.

14. The Board of Governors and the System generally are always subject to the will of Congress as may be expressed in legislative enactments and operate under the surveillance of Congressional committees. It should also be noted that coordination with economic policies of other branches of the Government is constantly maintained through exchanges of information and through consultation --

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regularly and frequently with the Treasury, often with the President's Council of Economic Advisers, and at times with the President. The broad objectives of governmental economic policies, set forth in the Employment Act of 1946, are considered to apply to Federal Reserve policies.

15. Reason for the relative independence of the Federal Reserve System within the governmental structure is more fundamental than the constitutional form of government. Even under parliamentary governments, authority to regulate the creation of money is generally delegated to a separate institution and is surrounded by safeguards against abuse either by government or by private enterprise, though not completely divorced from influence by either. In a free enterprise market economy, private credit institutions and practices inevitably serve monetary functions. These institutions and practices need to be regulated by legislative or regulatory devices but they cannot be wholly eliminated or replaced by governmental operations. Moreover, history has shown that governments, which are potentially, if not actually, substantial borrowers, are under constant temptation to create money in excess of the cash needs of the economy.

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16. In answer to questions by a committee of Congress, the Board traced the constitutional and historical basis for the authority assigned

to it. 3/ In that answer, it stated:

"......the Board of Governors and the Federal Open Market Committee ..... has been established by Congress to exercise important and unique functions of Government -- generally described as reserve banking functions -- which relate to the regulation in the public interest of the volume, availability, and cost of money; and, recognizing the need for independence of judgment in the exercise of these functions, Congress has indicated its intent that the Board and the Committee shall act according to their own best judgment and discretion, subject always to the limitations and policy directives prescribed by the law.

"Credit and monetary functions, like the functions of the judiciary, depend for their effective performance upon impartial and objective judgment.

"The country cannot prosper without a sound basic economy and sound credit conditions. To maintain such conditions, it is essential that money --- the 'medium of exchange' by which goods

3/ Monetary Policy and the Management of the Public Debt, Joint Committee on the Economic Report, 82d Congress, 2d Session, 1952. Part 1, pp. 242-248. See also Hearings, Statement by Lucius Wilmerding, Jr., pp. 752-754; and the Report of the Subcommittee, pp. 49-53.

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1/ Monetary Policy and the Management of the Public Debt, Joint Committee on the Economic Report, [illegible]

See also Hearings, Statement by Justin Williams, pp. 7[illegible]-7[illegible]; and the Report of the Subcommittee, [illegible]

" and services change hands -- must adequately and flexibly serve its purpose in a complex economy. To this end, some Government agency must be given the responsibility, under appropriate Congressional authority, for influencing the volume and availability of money in the public interest; and it is this responsibility which is vested in reserve banking authorities. ...

"Because money so vitally affects all people in all walks of life as well as the financing of the Government, the task of credit and monetary management has unique characteristics. Policy decisions of an agency performing this task are often the subject of controversy and frequently of a restrictive nature; consequently, they are often unpopular, at least temporarily, with some groups. The general public in a democracy, however, is more apt to accept or tolerate restrictive monetary and credit policies if they are decided by public officials who, like the members of the judiciary, are removed from immediate pressures.

"There is a long-established tradition both in this country and in other democracies that the proper exercise of reserve banking functions requires that it be insulated against private or public pressures whose immediate interests may not coincide with the best long-run interests of the country."

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authority, for influencing the volume and availability of money in the public interest; and it is this responsibility which is vested in reserve banking authorities. ...

"Because money so vitally affects all people in all walks of life as well as the financing of the Government, the task of credit

policy decisions of an agency performing this task are often the subject of controversy and frequently of a restrictive nature [illegible] they are often unpopular, at least temporarily, with some groups. The general public in a democracy, however, is more apt to accept or tolerate restrictive monetary and credit policies if they are decided by public officials who, like the members of the judiciary, are removed from immediate pressures.

both in this country and in other democracies that the proper execution of reserve banking functions requires that it be insulated against private or public pressures whose immediate interests may not coincide with the best long-run interests of the country."

17. In its final report, the subcommittee conducting this inquiry, in a discussion of the question of the independence of the Federal Reserve System with respect to the President, concluded that "the Board is formally independent in the exercise of its judgment and can make such decisions as it believes to be in the public interest." The Committee added, however:

> "But, the formal independence of the Board of Governors from the President is inevitably limited by the hard fact that fiscal and monetary policy must be coordinated with each other and with the other policies and objectives of the Government if the Government is to be of the greatest service to the Nation."

18. The unique status of the Federal Reserve System -- with its diffusion of authority in decision-making, the 14-year staggered terms of members of the Board of Governors, the establishment of regional Federal Reserve Banks, participation of Reserve Bank Presidents and Reserve Bank boards of directors in decision-making, and exemption of the System from governmental budgetary control -- are designed to safeguard its decisions against undue control by either private interest or public power.

19. It is nevertheless clear that the Federal Reserve System is governmental, not private. The Congress delegated to the various Federal Reserve bodies authority to exercise the principal monetary powers of Government. They are expected to be

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independent from control by the President and to be protected from partisan political influence, as well as from control by private interests. At the same time, they must take into consideration the aims and interests of all of these elements. The Federal Reserve as a whole is truly a public body vested with responsibility for administering the monetary system.

Differences in Established Procedures

20. In addition to the basic structural differences in the monetary systems of Canada and the United States, there have evolved from the experiences of the two countries a number of differences in procedures and practices in the conduct of monetary operations and policies that are significant in a comparative analysis of the two. Some of these might be subject to alteration in the course of time either through the process of volitional change in practices or by specific action with a view to improvement in instruments or techniques.

21. Reserve requirements of commercial banks. Administration of reserve requirements for commercial banks is more complex and probably somewhat more rigidly enforced in the United States than in Canada. Under the Federal Reserve System, member banks are required to maintain reserves either in the form of cash on hand or of balances with Federal Reserve Banks, but the amounts required vary as between time and demand deposits and also with respect to demand deposits as between two (until 1959, three)

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classes of banks.

22. The basis for these differences in reserve requirements is largely historical, stemming from the pre-Federal Reserve period when national banks and also most State-chartered banks held large parts of their reserves on deposit with correspondent banks, which in turn were required to hold larger proportions of cash reserves. Reserves of banks not members of the Federal Reserve System are mostly still required by State laws to be held in cash or on deposit with banks of a designated nature.

23. These differences in reserve requirements may also be said to be based upon a significant principle of monetary theory. They represent fundamental variations in the money quality of the different types of deposits. Demand deposits, which are used as a medium of exchange as well as a store of value, clearly have more impact upon the economy than time deposits. Broadly speaking, demand deposits at reserve city banks are much more actively used for transactions than are those at other banks. Thus, from the standpoint either of general monetary regulation or of distributing the burden of reserve requirements among individual banks, differentials in reserve requirements by types of deposits may be said to have a rational economic basis.

24. Computations of reserve requirements for member banks of the Federal Reserve System are based on weekly averages of daily figures for reserve city banks and on bi-weekly averages for other banks

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(commonly called country banks). Reports are submitted promptly by member banks to the Reserve Banks as to their reserve requirements and their holdings of coin and currency, which together with deposit balances at the Reserve Banks, are counted as reserves to cover requirements. Penalties are imposed for reserve deficiencies, which are relatively rare.

25. Many, perhaps most, large banks compute their reserve positions daily and, although they may be deficient on some days, they carefully watch their cumulative positions for the elapsed portion of the reserve week. As an aid in administration of monetary policy, a number of the largest banks in each district are requested to submit to the Reserve Banks daily reports of their reserve positions.

26. In Federal Reserve operations to influence the available supply of reserves attempt is constantly made to adjust the total supply of reserves to current reserve needs consistent with monetary policy goals, but individual banks must adjust their own positions to conform to requirements. Attention is given to other factors that may affect the supply of reserves available to member banks, such as gold movements, demand for currency, changes in Treasury and foreign official deposits at the Reserve Banks, and the volume of "float" represented by uncollected checks at the Reserve Banks. Information as to these changes is promptly available on a daily basis and may be estimated in advance with

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varying degrees of accuracy. As a result, variations in the available supply of reserves relative to reserve needs and in the distribution among individual banks have a prompt and sensitive impact upon money markets.

27. Role of the discount rate. Because of the atomized nature of the American banking structure, member bank borrowing from the Federal Reserve Banks is more frequent than is such borrowing at the Bank of Canada. This is because individual banks cannot always anticipate variations in their reserve needs. Borrowing may also be resorted to at times because the total supply of reserves made available may, as a matter of policy, not equal the total of required reserves plus excess reserves that some banks choose to hold; hence some banks find it necessary to borrow from the Reserve Bank. Banks generally do not view borrowing with favour and this tradition is encouraged by the Reserve Banks; hence borrowing, while supplying additional reserves to the banking system, has a restraining effect on credit expansion even though such borrowing in the aggregate is seldom more than a small percentage of total bank reserves.

28. Even when Federal Reserve policy is directed toward encouraging credit expansion by supplying reserves through open market operations, individual banks occasionally find it necessary to borrow to make temporary, generally unanticipated, adjustments in reserve positions. When banks are

faced with vigorous credit demands and credit expansion is being restrained, borrowing becomes more frequent and sustained.

29. Treasury bill rates are likely to vary in response to such variations in credit conditions and in the volume of member bank borrowings at the Reserve Banks. This is so because banks are likely to sell Treasury bills if necessary to pay off indebtedness and may sell bills to keep out of debt. If Federal Reserve discount rates are below or only slightly above Treasury bill rates, some banks may prefer to borrow rather than sell Treasury bills, particularly if the individual bank's reserve stringency is believed to be temporary, as is commonly the case.

30. Federal Reserve discount rates may be adjusted to deal with these varying situations. If credit expansion is being encouraged, then the discount rate may be kept close to the bill rate and not raised in case of a rise in the bill rate. Or, if increased reserve demands necessitating borrowing are known to be solely or largely of a temporary nature, an increase in the discount rate may be considered inappropriate. If, on the other hand, credit expansion is being restrained, the discount rate needs to be raised as the bill rate rises. At times, other factors may be considered in fixing the discount rate, such as for example the international balance of payments of the country. Moreover, the degree of restraint on banks exerted by the discount rate depends not only on the level

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relative to bill rates but also on the volume of borrowing, the number of banks involved, and the continuity of borrowing by individual banks.

31. For these reasons, automatic variations in the discount rate in response to changes in the rate on Treasury bills, as is done in Canada, have not been considered appropriate to the United States situation. It should be said, however, that there are those who hold a different view.

32. Regulation of interest on deposits -- Since 1933 member banks and since 1935 all banks whose deposits are insured by the Federal Deposit Insurance Corporation have been prohibited from paying interest on demand deposits, and the rates they could pay on time deposits have been limited by regulation. These provisions were evidently designed to prevent banks from competing for deposits by paying rates of interest that would induce acquisition of unsound assets. The prohibition of interest payments on demand deposits, moreover, was particularly designed to limit the low of balances to city banks, which in the past used the funds principally to lend on call to finance stock market speculation in margin accounts.

33. Such practices were considered to be in part responsible for the excessive stock market speculation on credit in the late 1920's and the subsequent collapse of the financial system with widespread bank failures. Other, probably more basic, causes of the difficulties of the 1920's and early 1930's and

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other reasons for the dominating importance of the stock market call-loan market have been corrected since 1933 by the imposition of margin requirements on stock-market credit, along with other regulations of stock trading, and by the development of the market for Treasury bills. Yet the prohibition of interest on demand deposits has probably also been a factor in diminishing the role of New York banks in the money market since the 1920's.

34. Other reasons may be advanced for the continuation of such a prohibition. One is that the liquidity provided by demand deposits is a sufficient inducement for their being held without any interest return. A corollary reason is that holders of liquid assets wanting an interest return should undergo the risk of converting the funds into cash when cash is needed and not impose that risk on banks. If a bank must pay interest to attract the funds, it must invest them in higher yielding less liquid assets and run the risk of loss when the funds are withdrawn. This is a part of reasoning that such payments may lead to unsound banking practices.

35. Regulation of the amount of interest that may be paid on time deposits may likewise be considered desirable as a means of discouraging competitive practices that might endanger the soundness of individual banks and perhaps the banking system as a whole. Another strong reason is that, with differentials in reserve requirements against time and demand deposits and with prohibition of interest payments on demand deposits, some gradation is

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needed. It is for this reason that the permitted maxima on deposits held for shorter periods are lower than the maximum permitted on those held for longer periods of time.

36. The line of distinction between time and demand deposits is not a sharp one. Banks are under some inducement to attract time deposits, because of the lower reserve requirements. If they are led by competition to pay relatively high rates for short-term, highly volatile deposits, the distinction between demand deposits and time deposits becomes less clear. The breakdown of such distinction would tend to defeat the monetary-policy reason for requiring lower reserves against time deposits.

37. Maintenance of well-defined distinctions between time and demand deposits is not so essential in Canada, where reserve requirements on demand and time deposits are the same and where interest payments on deposits are not regulated. Whether or not the Canadian practices in any way encourage unsound banking habits or interfere with the proper conduct of monetary policies, I do not feel qualified to discuss. The danger may be less in the case of larger, more diversified, branch banking systems than with numerous small, localized banks.

38. Role of central bank in public debt management. In both Canada and the United States, the central banks serve as agents for the Treasury in the handling of public debt operations and other fiscal matters. If my understanding is correct, the

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role of the Bank of Canada in public debt management is more active and is exercised with a higher degree of responsibility for decisions as to types of issues and timing than is the case with the Federal Reserve Banks. On the other hand, the commercial banks are used in effect as underwriters of public debt offerings in the United States in a manner not found in Canada.

39. Federal Reserve Banks are specifically empowered by law to act as depositaries and fiscal agents for the Treasury. In the performance of these functions the principal-agency relationship is direct between the Treasury and the individual Reserve Banks. The Board of Governors does not directly enter into this relationship. The Treasury keeps relatively small active balances on deposit at each of the Federal Reserve Banks and their branches. Disbursement of Government funds is mostly by cheque drawn on the Treasury accounts at the Federal Reserve Banks. The Reserve Banks receive certain Government receipts for the credit of the Treasury.

40. Commercial banks may become "special depositaries" of the treasury and carry "tax and loan deposit" accounts, which must be secured by Government securities or other acceptable collateral. A bank designated as a special depositary credits to the tax and loan account the proceeds of its customers' and its own subscriptions to Government securities issued by the Treasury from time to time. Banks also receive and credit to tax and loan accounts taxes paid by or

withheld at the source by large business customers of the respective banks. As the Treasury calls for the funds, they are transferred to a Treasury account at a Federal Reserve Bank and become available for disbursement.

41. Tax and loan deposit accounts are a convenient device for the sale of Government securities in large volume and, coupled with their use for tax receipts, provide a means of moderating the effect on member bank reserves of fluctuations in the Treasury's cash receipts. The great bulk of Government deposits is carried by the Treasury in these accounts, pending transfer to the Federal Reserve Banks. Each Federal Reserve Bank administers for the Treasury the tax and loan deposit accounts of the banks -- both member and nonmember -- in its district.

42. Use of the tax-and-loan account procedure provides in effect a unique and effective means of underwriting both large and small issues of Government securities. Individual banks obtain an advantage in being able to acquire securities and then to hold them for a period without making payment in cash. The funds are drawn upon by the Treasury over a period of time as they are needed to meet expenditures and thus are returned promptly to the banks, although not necessarily the same bank.

43. This procedure avoids the necessity of having the central bank purchase a large part of a new issue and endeavour to sell it as the funds are expended by the Treasury, as is done in some countries.

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In fact, the Federal Reserve Act does not permit the Federal Reserve Banks to lend directly to, or buy securities directly from, the Treasury, except to a limited extent.

44. The Federal Reserve Banks, as fiscal agents, perform various services for the Treasury in connection with the issuance of new Government securities, the periodic auctions of Treasury bills, and redemption or exchanges of maturing issues. The Federal Reserve Bank of New York also executes transactions in United States Government securities in connection with the management of various trust and agency funds administered by the Treasury.

45. In all of these operations, the responsibility for decisions as to specific operations rests with the Treasury. In making many of the decisions Treasury officials consult with Federal Reserve officials, particularly the Federal Reserve Bank of New York, especially with respect to operations that may have an effect on the reserve position of banks and the money market. Officials of the Board of Governors and often officers of other Reserve Banks are also consulted by the Treasury with respect to new issues of securities and market developments. There are constant and close contacts between Treasury and Federal Reserve staffs not only on operating matters but also on questions of information and analysis.

46. <u>International position</u>. Monetary policies in Canada and the United States may also be differently influenced by their positions with respect

to the international balance of payments. In general, Canada receives a large net inflow of capital sufficient to offset a customary excess of imports over exports on current account. Its payments balance is generally subject to wide variations in magnitude. Canadian monetary and fiscal policies have had to be formulated with these considerations in view, and various means, including fluctuating exchange rates and at times in the past controls of borrowing abroad, have been used to deal with that situation.

47. In the United States, until recent years problems of the balance of payments and of dollar convertibility have not been important considerations in the determination of monetary policy. They were of concern only as it was necessary or desirable for domestic purposes to offset the effects of gold movements on the reserve position of banks. Or it might be said that, because of the strained reserve positions of other countries, U.S. policies actually facilitated outward movements of funds and thus the accumulation of gold and dollar reserves by other countries.

48. During the past three or four years, however, i.e, since the restoration of convertibility in the leading industrial countries, large deficits in the United States balance of payments and consequent drains or threatened drains on the U.S. gold stock have necessitated some moderation of policies. In order to avoid encouraging capital flows due to interest rate differentials or to excess availability over domestic wants, monetary policies have not permitted

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or promoted declines in interest rates to levels that might otherwise have been permissible or desirable for domestic purposes.

49. Since the U.S. dollar is extensively used as a vital reserve currency throughout the world and foreigners maintain very large dollar holdings, it is essential that there never be any question as to the convertibility of the dollar at an unchanged rate into gold or into some generally acceptable international medium of exchange and store of value. For the present and the foreseeable future, monetary and fiscal policies in the United States must be conducted with a view to maintaining confidence in the convertibility and stability of the U.S. dollar.4/

II. Broad Objectives of Monetary Policy

50. Although there are significant differences in structure of monetary institutions, in operating procedures, and in emphasis placed on different phases, the broad objectives of monetary policy for nearly every country in modern times may be expressed in approximately identical terms. The broad purpose is to influence monetary and credit developments so as to make a maximum contribution to general welfare, while endeavoring to assure convertibility of the currency of the country in international payments.

4/ International considerations in the determination of Federal Reserve policies are discussed more fully in Part V of this memorandum.

51. Expressed more specifically, the broad objectives of the Federal Reserve may be said to be fourfold:

1. To assure availability of a sufficient supply of bank credit and cash money for sustained economic growth and development.
2. To help maintain reasonable stability in the purchasing power of the currency -- i.e., in the general level of prices -- by avoiding inflation or deflation.
3. To assure international convertibility of the currency by protecting the country's gold reserve and its foreign exchange position.
4. In endeavoring to achieve these other objectives, to maintain the operation of free markets in a free enterprise system.

52. These objectives of goals are expressed in broad terms and they are the aims of economic policy in general, not merely of Federal Reserve policy. In fact, Federal Reserve policy cannot assure their achievement, although unwise monetary policies may interfere with or prevent their attainment. The processes and procedures through which monetary policy is executed, or what may be called the more immediate objectives of Federal Reserve policy, are necessarily more specific than these broad goals, but they can never be dissociated from them.

53. Formulation and execution of monetary policy is a continuous process that requires constant

review of economic and financial developments and adaptation to such developments. As stated in the Board's answers to questions by the Commission on Money and Credit.

> "Implicitly involved in the consideration of policy are three interrelated questions: In what respects is the whole constallation of past and prospective events, as seen at a given moment, contributing to or detracting from price stability, high level employment, and economic growth? In what respects does it lie within the power of the Federal Reserve to set forces in motion, either to foster the attainment of these goals or to counter any threats to that achievement? What specific action should the Federal Reserve take?"

54. Nearly everyone accepts or takes for granted the ultimate goals of price stability, high-level employment, and sustained economic growth. It is important to emphasize that these various goals need not be viewed as conflicting alternatives. Policy formulation does not necessarily involve choices as between price inflation or unemployment; or price stability as against growth; or a balance in international accounts as against full employment or growth. Inflation is likely to lead eventually to collapse or at least interferes with the attainment of a maximum potential in resource utilization. A price or interest rate structure that upsets balance in international payments is also a defective basis

for domestic growth and full employment.

55. With respect to consideration given to these broad objectives in policy formulation, again the Board's answer to the Commission on Money and Credit may be quoted:

"Information required for the broad and continuing analysis of economic forces pertinent to policy decision is almost unlimited in scope. Information available at any time is limited and judgments must often be based on incomplete facts. Even more important than the information itself are the judgments that must be made in interpreting the data: for example, judgments as to the stage of the business cycle the economy has reached, involving views as to whether consumption, saving, and investment are in balance or are showing signs of disequilibrium; judgments as to the climate of expectations about price movements, equity values, and interest rates; and judgments as to the trend of the international balance of payments. It is in the light of judgments such as these that decisions must be reached as to the appropriate degree of restraint or encouragement to be imposed on expansion of bank credit."

III. Instruments of Federal Reserve Policy

56. It must be recognized that Federal Reserve policies taken alone cannot be relied upon to assure the achievement of these broad objectives. The specific influence of Federal Reserve actions is much more limited. They affect principally liquidity and credit and more directly bank credit and liquidity held in the form of cash balances. The primary responsibility of the Federal Reserve may be expressed even more narrowly as determination of the volume of member bank reserves. Quoting the Board's answers to the Commission on Money and Credit:

> "Whatever broad influences may flow from (Federal Reserve) actions, ... the particular economic or financial variable over which they have anything approaching full and direct control is the total of commercial bank reserves. Through this control, they exert a strong influence directly on total loans and investments and total deposits of banks and indirectly some influence on spending, investment, and saving by the public in general. At any given moment, therefore, the choice for Federal Reserve policy lies between various degrees of restraint upon or encouragement to expansion of bank credit through altered reserve availability."
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* * * * * *

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57. In performing its responsibility for the regulation of bank reserves, the Federal Reserve relies principally upon three well-known instruments; discount operations, purchases and sales of securities and bills in the open market, and changes in reserve requirements. These instruments are used in a complementary fashion to affect the availability and cost of member bank reserves.

58. In the United States, each member bank is required to maintain a reserve balance with its Federal Reserve Bank, together with coin and currency held in its own vaults, equal to specified percentages of its demand deposits as defined for this purpose and of its time deposits. The required reserve base constitutes the fulcrum for the System's monetary operations. With a given level of reserve requirements, changes in the volume of member bank reserves, permitted or brought about by System action, affect directly the ability of member banks to extend credit and to assume deposit liabilities.

59. Policy is effected by regulating the supply of reserves relative to the amounts that banks are required to hold. Other factors than Federal Reserve operations influence the supply of reserves. In determining the appropriate volume of reserves that should be supplied through Federal Reserve operations, these effects must be taken into consideration -- to be either offset or permitted to hold. These factors include:

(a) gold transactions;

[illegible]

[illegible] discount operations, purchases and sales of securities and bills in the open market, and changes in reserve requirements. These instruments are used in a complementary fashion to affect the availability and cost of member bank reserves.

58. In the United States, each member bank is required to maintain a reserve balance with its Federal Reserve Bank, together with coin and currency held in its own vaults, equal to specified percentages of its demand deposits as defined for this purpose and of its time deposits. The required reserve base constitutes the fulcrum for the System's monetary operations. With a given level of reserve requirements, changes in the volume of member bank reserves, permitted or brought about by System action, affect di[illegible] and to assume deposit liabilities.

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(b) changes in deposits at the Reserve Banks of foreign official bodies or international agencies;

(c) changes in currency in circulation;

(d) Treasury operations involving shifts of deposits to or from the Reserve Banks; and

(e) changes in Federal Reserve float, i.e., the excess of checks in process of collection that have been credited to member bank accounts over those not yet charged against member bank accounts.

Specific Federal Reserve operations used to influence the supply of reserves may be briefly described as follows:

60. <u>Discounts.</u> -- Member bank borrowing at the Reserve Banks, together with the rate of discount charged on such borrowing, was originally considered to be the basic instrument of Federal Reserve policy. Borrowing is done at the initiative of member banks to obtain reserves, generally because they are needed to restore deficiencies. These deficiencies may have resulted from shifts of deposits to other banks or withdrawals of currency. Drains on reserves of an individual bank or an increase in deposits and thus in required reserves without any accompanying increase in available reserves might have grown out of expansion of loans or investments.

61. A growing volume of discounts, experience has proven, is a powerful factor acting to brake bank

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credit expansion. This is true, notwithstanding the fact that discounting is a source of additional reserves to member banks. One of the functions of the discount mechanism is to serve as a safety valve, providing a temporary means of adjustment to the frequent reserve deficiencies that occur at times of pressure on reserves. But use of the safety valve does not provide an escape from monetary restraint.

62. For one thing, use of the safety valve can be made more expensive by increases in Reserve Bank discount rates. Secondly the very fact of being indebted -- to the Reserve Bank or to others -- tends to make banks restrict credit expansion and to use new reserves that come into their possession to repay their indebtedness rather than to expand credit. This follows both from the traditional reluctance of banks to assume liabilities that take precedence over those to depositors and from Federal Reserve practice in administering the discount window, which ordinarily discourages reliance on discounting for extended periods.

63. Ability of banks to borrow reserves thus imparts a degree of flexibility to the impact of Federal Reserve policy but becomes increasingly restraining as borrowings are expanded or continued. Evidence of the restraining effect of member bank borrowing is found in the fact that the variations in money market interest rates are closely related to the volume of borrowing, as well as to the level of the discount rate.

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conducted at the initiative of the Federal Reserve, affect the availability of non-borrowed reserves for banks in general. They are conducted so as to encourage banks to expand credit without the restraint of borrowing or alternatively to prevent expansion or make it necessary for banks to borrow for the purpose. This is the most delicate and most used instrument of policy and has a pervasive effect on credit availability channeled through the money market.

65. Open market operations are utilized to regulate the volume of member bank reserves from day to day and from week to week. Each purchase of securities -- usually Treasury bills -- adds to member bank reserves and each sale absorbs member bank reserves. Open market operations are well suited for shorter term reserve changes, including those called for by seasonal variations in currency and credit needs and by intra-monthly changes in reserve needs. In addition, open market operations are used to establish the reserves needed for economic growth and also to vary reserves in accordance with cyclical movements in the economy.

66. Open market transactions by the System and the discount function operate in close association. In a period of monetary restraint, open market operations provide a smaller amount of reserves than the banks are seeking as they attempt to satisfy the economy's demands for credit, or such operations at times may even absorb reserves, although absorption of reserves is usually effected only to cover a decline in reserve

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needs following a seasonal or other temporary expansion in the reserve supply. As a result, individual banks, to meet loan demands, may dispose of Government securities in the market, or call demand loans, or if they are unwilling to liquidate assets, they have to borrow from the Reserve Banks. Such action serves to reduce bank liquidity and this in time works as an influence to check loan expansion by the affected banks.

67. Changes in reserve requirements of member banks may be used to affect the availability of reserves for credit extension without changes in the total volume of reserves. It is essential that reserve requirements be closely related to the availability of reserves. The Board of Governors has authority to vary the reserve percentages for each of the two classes of banks within specified limits set by law. A change in reserve requirements is not a delicate instrument adaptable to day-to-day and short-run operations. It affects all or large groups of banks regardless of the locus of current needs or demands and generally calls for notice well in advance of effective dates. It is primarily useful for making major adjustments in the availability of reserves. An increase in requirements is especially difficult to impose because of the impact of adjustments in case there are no excess reserves. Increases can, however, be used for absorbing rather large redundancies.

68. Other measures. -- Besides the three major instruments of policy discussed above, the System also has regulatory powers over margin requirements in con-

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nection with stock market credit and at times in the past has had comparable powers over real estate and consumer instalment credit. These selective credit instruments, supplementing general regulation of member bank reserves to influence the total flow of bank credit and money, affect the borrower's equity or the rate of his debt retirement or both and serve to restrain demands for the types of credit covered.

69. Selective credit regulation in the United States by these techniques has been designed to influence the credit flow in financing areas shown by experience to be highly volatile in movement, either cyclically or for other reasons. Such measures are best applicable for regulating types of credit that may not be sufficiently susceptible to controls over reserve availability and are, or might become, so important as to be a serious unstabilizing influence. This was the case for brokers' loans in the 1920's.

70. Disadvantages of their use result mainly from problems of administration and equity in dealing with a variety of lending institutions, including nonbank lenders less susceptible to Federal Reserve regulation than banks, and also in handling a complex variety of transactions. Except in a clear-cut case of widespread unstabilizing effects caused by a particular practice, it is believed to be preferable to exert the influence of monetary policy through general regulation of the over-all availability of credit, leaving allocation to be determined by market processes.

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to induce banks or other lenders to restrict loans or investments of particular types or to keep the total within specified limits has seldom been resorted to in the United States. Where attempted they have usually met with little success. The reason for this is partly the difficulty of keeping under control the large number of banks and other lending units. Such efforts place an inequitable burden on those that comply relative to those that evade or ignore the regulations. These methods are also considered undesirable because they may interfere unduly with the functioning of market processes.

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IV. Guides to and Effectiveness of Federal Reserve Actions

72. It follows from the previous discussion that, although the ultimate goals of monetary policy are expressed in broad terms, the immediate primary guide to Federal Reserve operations is the reserve position of banks. In an answer to a question from the Joint Economic Committee of Congress, 1/ the Chairman of the Board summarized the influence of monetary policy as follows:

> "....Monetary policy exerts its influence almost immediately and directly upon the volume of commercial bank reserves, the amount of which can be promptly and accurately measured and can be largely controlled by Federal Reserve actions on its own initiative. This control is not complete because member banks may on their initiative borrow reserves or use reserves to reduce borrowings at the Reserve banks. Through the medium of bank reserves, policy actions influence the money supply. These secondary effects are in turn strongly affected by the attitudes and actions of banks in adjusting to changes in reserves and in their willingness to borrow from the Reserve Banks. They are also affected by the decisions of borrowers with respect to the use of bank credit.

1/ "Review of Annual Report of the Federal Reserve System for the Year 1960", U.S. Government Printing Office, 1961, p.154.

"Ultimate consequences of changes in the money supply upon general economic activity, employment, and prices are determined by eventual holders of funds, who are motivated by many factors other than cash holdings. More especially, the bulk of current financial transactions reflects the use of existing funds rather than changes in the total volume of cash balances and these uses are likewise influenced by many factors of a nonmonetary nature. All of this means that, although monetary policy actions have marginal effects of significance, assessment of these consequences is generally difficult and sometimes impossible. It must be to some extent a matter of judgment."

73. Decisions made by the Federal Open Market Committee as to the degree of restraint or encouragement that should be imposed on bank credit expansion are reached after careful consideration and discussion of the economic situation in general, with particular attention to factors that relate to bank credit developments. These decisions are made at meetings of the Committee held approximately every three weeks.

74. In preparation for such meetings, members of the Committee, and other participants, are supplied with comprehensive analyses of economic and credit conditions supplied by staffs of the Board and the respective Reserve Banks. At the meetings, following brief staff reports of operations and analytical economic reviews, each Reserve Bank President presents a statement of

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regional conditions and, together with Board members, states his views as to what policy actions should be adopted.

75. The policy decision reached by the Committee cannot be interpreted or illustrated by any precise mathematical formula. It is expressed in terms of a directive issued to the Manager of the Federal Open Market Account at the Federal Reserve Bank of New York. These directives and the reasons for their adoption are subsequently published in the Record of Policy Actions included by statutory requirement in the Annual Report of the Board of Governors. The latest published directive adopted in December 1961 reads as follows:

> "It is the current policy of the Committee to permit further bank credit and monetary expansion so as to promote fuller utilization of the economy's resources, together with money market conditions consistent with the needs of both an expanding domestic economy and this country's international balance of payments problem.
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> "To implement this policy, operations for the System Open Market Account shall be conducted with a view to providing reserves for bank credit and monetary expansions (with allowance for the wide seasonal movements customary at this time of the year), but with a somewhat slower rate of increase in total reserves than during recent months. Operations

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" shall place emphasis on continuance of the 3-month Treasury bill rate at close to the top of the range recently prevailing. No overt action shall be taken to reduce unduly the supply of reserves or to bring about a rise in interest rates."

76. In conducting operations the Management is guided by the directive formally adopted, by the discussion of the economic situation, and by any more specific or detailed instructions that might have grown out of views expressed at the meetings. The substance of these discussions and views is published in the Record Actions. Operations are conducted within limits imposed by the directive and by various continuing operating procedures that have been adopted by the Committee. Between meetings members of the Committee are promptly informed of all operations.

77. Factors considered by the Committee in making its policy decision are numerous and are both broad and narrow. As the Board stated in its answers to the Commission on Money and Credit:

"It follows that in formulating policies the Federal Reserve authorities must be cognizant of developments with respect to production, employment, and prices, as well as the financial variables more directly affected by monetary policies. They must appraise the course of developments and make judgments as to any emerging imbalances and their causes. These analyses require the assembly and interpretation of a large amount of information

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" in many aspects of the economic situation -- foreign as well as domestic."

78. Factors considered by the Management of the Open Market Account in conducting short-term operations are somewhat narrower and more specific. Tests of the effectiveness or limitations of policy are necessarily rather broad and must take into consideration all factors other than monetary policy that may have exerted an influence. The principal considerations that bear upon all of these judgments will be discussed separately.

79. <u>Production, employment and prices</u>. -- Basic to decisions by the Open Market Committee as to open market operations and by the Board and Reserve Bank officials as to discount-rate and other policy actions are the broad national objectives of price stability, high level employment, and economic growth. The Board of Governors and the Open Market Committee have always given close attention to the movement of production, employment, and prices, both in general terms and with respect to components. In the 1920's the Board constructed and published index numbers of the physical volume of industrial production and also indexes of factory employment and payrolls. The industrial production index has frequently been revised to incorporate improvements in underlying data and techniques. The Reserve Banks have also for over 40 years collected statistics of sales and inventories from department stores. The Federal Reserve also makes constant use of economic statistics obtained from other

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78. Factors considered by the Management of the Open Market Account in conducting day-to-day operations are somewhat narrower and more specific. Tests of the effectiveness or limitations of policy are necessarily rather broad and must take into consideration all factors other than monetary policy that may have exerted an influence. The principal considerations that bear upon all of these judgments will be discussed separately.

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80. With regard to achievement of the broad aims of policy, the Board of Governors pointed out in its answers to the Commission on Money and Credit:

".....Satisfactory achievement of these objectives depends on actions of the Congress and the Executive and on actions of people in all walks of life. Disturbances to economic stability and growth may arise in many ways. Generally, the roots of the trouble develop long before overt signs are clearly seen. In an industrial economy, growth tends to proceed irregularly through cycles of advance and recession or pause. Some cyclical variation may be the unavoidable result of the self-correcting forces of the market system. A flexible price system is essential for maintaining balance between production and consumption of particular goods and services. At times structural imbalances develop that cannot be corrected by general public policies.

"The task of public policies is to endeavor to detect forces of disturbance and to temper excessive movements in one direction or another so far as possible. Federal Reserve powers contribute most to the achievement of the national objectives of price stability, high level employment and economic growth when they are so exerted as to minimize price inflation or deflation, to damp

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" down expectations of sudden and violent changes in commodity prices or in equity values, and to prevent unsustainable expansion or discourage harmful contraction in bank credit. The immediate task of Federal Reserve policy is to decide upon the degree of restraint or encouragement to be imposed on bank credit expansion consistent with achievement of national objectives. This may mean helping to check unstabilizing developments in the economy influenced by credit factors when they become apparent. It also means helping to prevent such disturbances from occurring.

"Federal Reserve policies, it needs to be kept in mind, are exerted through influencing the total volume of bank credit and money. It lies beyond the powers of the Federal Reserve to promote growth of particular segments of the economy without affecting other segments in ways that may or may not be desirable. It is likewise difficult or impossible to restrain particular activities without exerting general restraint.

"Clearly actions by the Federal Reserve alone cannot assure the attainment of the broad national objectives. Attempts to assure continuous stimulation of over-all growth through bank credit expansion, regardless of other developments, might incur the risk of inflationary or speculative developments that would be unsustainable and thus create instability and unemployment or they may

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83. These repetitive variations in the Federal Reserve portfolio are almost wholly for the purpose of covering normal seasonal movements and other temporary changes in required reserves (resulting from similar movements in deposits) and in currency and in various factors affecting the supply of reserves. The task of meeting these temporary and special needs is in essence not a policy matter, but a technical operating problem of measuring or otherwise detecting such variations and making prompt adjustments to them.

84. Federal Reserve operations to cover reserve needs resulting from cyclical or growth movements in bank deposits in any short period of time such as a week or a month are only a fraction of operations necessary to offset the effects of variations in many of the factors that influence the available supply of reserves.

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86. A somewhat narrower and perhaps more specific indicator of Federal Reserve intentions, or the posture of policy, at the time is provided by the often-used figure of "net free reserves" or "net borrowed reserves". This figure is the difference between total excess reserves (over requirements) held by member banks and the total borrowings of member banks. Banks holding excess reserves and those borrowing at any one time are generally, but not always, different groups.

87. As a matter of practice in recent years, some banks (mostly small country banks) regularly hold excess reserves; the aggregate of such holdings fluctuates rather consistently around $500 million. Additions to the supply of reserves generally are reflected fairly promptly either in a reduction in member bank borrowings at the Federal Reserve Banks or in credit and monetary expansion, rather than in additions to excess reserves. Reductions in the supply of reserves generally do not result in a decrease in excess reserves, but more likely cause some banks to increase their borrowing, which may vary from practically nothing to a billion dollars or more. Reductions in reserves might conceivably lead to credit liquidation, but it is rarely the aim of monetary policy to bring about a contraction of credit, except as an adjustment

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87. As a matter of practice in recent years, some banks (mostly small country banks) regularly hold excess reserves: the aggregate of such holdings fluctuates rather considerably around $400 million. Additions to the supply of reserves generally are reflected fairly promptly either in a reduction in member bank borrowings at the Federal Reserve Banks or in credit and monetary expansion, rather than in additions to excess reserves. Reductions in the supply of reserves generally do not result in a decrease in excess reserves, but more likely cause some banks to increase their borrowing, which may vary from practically nothing to a billion dollars or more. Reductions in reserves might conceivably lead to credit liquidation, but it is rarely the aim of monetary policy to bring about a contraction of credit except as an adjustment

from a seasonal or other temporary expansion. Hence, excess reserves by themselves are not a good indicator of changes in the posture of policy.

88. The general level of net free or net borrowed reserves prevailing over a period of time provides a measure of the degree of restraint or ease that exists in the money market. The particular level that may be needed to achieve the broader objective of appropriate credit expansion varies from time to time depending on changing economic conditions. Banks are willing to borrow more in times of vigorous credit demands than when demands are slack. The more significant underlying indicator is the amount of credit and monetary expansion that occurs. Hence constant attention must be given to the amounts of required reserves and total reserves outstanding.

89. These various reserve data -- or rather, fairly reliable estimates -- are available on a daily basis for the guidance of the Account Management. In fact, estimates or projections of reserve needs and the factors that may affect the reserve supply for days and weeks ahead are constantly being compiled by the Federal Reserve staff so that allowance may be made in current operations for possible variations in the immediate future.

90. <u>Secondary liquidity of banks</u>. -- In addition to primary liquidity, as represented positively by the availability of reserves and negatively by bank borrowings, the credit practices of banks are also influenced by holdings of other liquid assets. This

secondary liquidity consists of those assets, which ordinarily can be readily liquidated by a bank at close to the book value in order to meet deposit drains or adjust reserve positions. Secondary liquidity is a matter of individual bank initiative and is only indirectly influenced by the Federal Reserve. In our system of thousands of unit banks with continuous and widely varying interbank flows, the holding of some amount of such assets is essential for individual banks.

91. Secondary liquidity, however, it must be clearly kept in mind, does not by itself provide the basis for expansion in bank credit. Nor would specific requirements as to holdings of liquid assets, other than primary reserves, necessarily restrict the expansibility of credit. These secondary reserve assets are in themselves a form of bank credit; their acquisition result in the creation of deposits. Secondary reserve requirements, therefore, would exert restraint on total credit expansion only in case the available supply of eligible assets were limited.

92. The ultimate limitation on bank credit expansion is the availability of primary reserves. If banks have or could readily obtain primary reserves, they could then acquire the requisite amount of secondary reserve assets (if available in the market). In the process the banking system as a whole would be in a position to expand total credit by multiples of these two sets of reserve holdings. For example, if banks could purchase Treasury bills in the market and

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93. In the absence of unlimited access to primary reserves or to secondary reserve assets, a requirement or traditional practice as to holdings of other liquid assets would, to be sure, limit the ability of the banking system to expand loans or other assets. For this reason, the secondary liquidity position of banks sometimes needs to be taken into consideration in determining monetary policies.

94. Bank credit and the money supply. -- Broader goals or guides for monetary policy are evident in the consequences of changes in reserve availability in affecting the amount of total loans and investments of banks, which result in the creation of the bulk of the cash balances that the public holds. The banking system as a whole differs from other financial institutions in that commercial banks as a group can expand a given supply of reserves into loans and investments and into cash balances amounting to many times the initial amount. At the same time the volume of bank credit and money that can be created is limited by the amount of reserves available relative to the amount required to be held by banks.

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96. Since the impact of monetary policy on the economy is transmitted through changes in bank credit and the money supply, it is essential for policy formulation that there be continuous assessment of the adequacy of these magnitudes. This is not an easy task, but it is one that the Federal Reserve, with its power to control the creation of credit and money, must endeavor to perform. Monetary policy decisions must be based upon judgment as to the total amount of bank credit and money that is appropriate at any time. They must take into consideration not only the total volume but also the rate and nature of use of money. The use of money cannot be controlled by the Federal Reserve.

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could result in an undue stimulus to spending and investing, which would derive, first, from increased spending growing out of bank credit expansion and, second, from the creation of a redundant money supply, i.e., excessive liquidity.

98. In conducting current Federal Reserve operations, estimates or assumptions as to total loans and investments of banks and the money supply underlie the current and projected figures of total reserves and free reserves. Seasonal and other temporary variations in these elements are quite large -- amounting to as much as $5 billion in the course of the year. In conducting operations to carry out the Committee's objectives, the Account Management has to allow for the effect of such movements on reserve needs.

99. Since cyclical and growth changes in the money supply and in required reserves are relatively small in any short period of time, during the intervals between meetings of the Committee those operations that carry out broad monetary policy objectives are insignificant relative to those needed to cover purely temporary variations. The essential task is to prevent temporary factors affecting reserve availability from interfering with policy goals.

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theory, relates to what definition of the money supply may be considered appropriate for purposes of monetary regulation. Or, perhaps more correctly stated, what weight should be given to the various components of the whole spectrum of liquid assets held by the public in affecting the volume of economic activity.

101. Currency -- including notes and coin -- is of considerable importance from the standpoint of monetary policy because changes in the volume in circulation outside of banks has a direct one-for-one effect on the volume of bank reserves. In the United States, however, the volume of currency in circulation amounts to less than a third of that of demand deposits held by the public and no doubt is used for a smaller proportion of all monetary transactions relative to checks drawn on deposits.

102. Demand deposits are the most important component of the money supply. Under a fractional reserve system, they are also more expansible on the basis of a given amount of reserves. Interbank deposits may be excluded because they represent duplication. United States Government deposits in commercial banks, even though they reflect bank credit extension, are generally not included in measures of the money supply. This rather arbitrary practice is partly because such funds may be viewed as for the time withdrawn from influence on spending decision but more particularly because such deposits are subject to wide and erratic variations that do not reflect changes

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in money available to the public at the time.

103. Treatment of time deposits at commercial banks raises difficult questions. Their significance has varied from time to time as banks have followed different practices with respect to the attraction of such deposits and their potential liquidity. Principally they are no doubt merely a form of savings and a store of value with little current economic impact. To some extent, however, they are substitutes for other forms of money holdings and influence the spending decisions of money holders. They are reflected in the total volume of bank credit and also, to a smaller degree than demand deposits, in reserve needs. Hence they must be taken into consideration in determining monetary policies, but should not be viewed as identical on a dollar-for-dollar basis with demand deposits. The significance of holdings of other types of liquid assets is discussed in a later section.

104. <u>Velocity of money</u>. -- Whereas changes in the volume of money are influenced in part by decisions of borrowers and in part by those of banks and the Federal Reserve, changes in the use of money result principally from the decisions of borrowers, of holders of money, of spenders, and of nonbank lenders. From the standpoint of performance of the economy, it is not the holding of money but the use of money that counts. Amounts held, to be sure, may influence decisions as to the use of money. If new money created keeps moving to holders who do not want to hold more

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cash, the flow and the turnover of money can expand rapidly. Experience shows that the rate of use or velocity of money varies significantly over short periods of time, as well as over long periods.

105. Monetary policy decisions, therefore, must take into consideration variations in monetary turnover. These variations are in essence a reflection of the great variety of elements that comprise economic activity and determine stability or instability in prices, the degree of resource utilization, and the rate of economic growth, i.e., the broad, ultimate objectives of policy. Variations in monetary turnover are related to changes in non-bank credit, in elements of liquidity other than money, and in interest rates, which are discussed in subsequent sections.

106. Nonbank credit. -- As already mentioned, monetary policy is more or less limited in the scope of its direct influence. It operates primarily through the channel of bank credit, which constitutes a relatively small portion of total credit and the total flow of funds. Over the past decade net annual increases in total credit and equity market instruments in the United States, as measured by the Federal Reserve compilation of flows-of-funds accounts, have generally been between $30 billion and $60 billion -- perhaps $50 billion or somewhat more would be a normal average at present.

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108. Therefore, as the Board points out in its Commission on Money and Credit answer,

> "Flows of other funds -- evolved over time from accumulated savings and outside the control of the banking system -- are of much greater magnitude and generally of greater influence in determining the course of the economy than are those deriving from changes in the volume of bank credit. The ultimate flows of all these funds into particular uses are beyond the direct control of the Federal Reserve. Nevertheless, changes in the availability of bank credit have a marginal influence upon money flows and upon interest rates that, if not properly controlled, can affect economic stability adversely."

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109. General liquidity. -- A related reason why Federal Reserve policy decisions cannot be made solely in terms of money supply goals is that economic decisions are influenced by all elements of liquidity, including holdings of other assets as well as of money balances. Decisions of spenders and lenders are likely to be influenced by the degree of their liquidity existing at any point in time and by variations in their liquidity over time.

110. Particular actions available to the Federal Reserve to restrict holdings of assets other than cash balances are limited. Yet sharp increases in time deposits at commercial banks that followed the recent raising of ceilings on interest payable by banks on such deposits indicate that variations in these rates can influence the volume of time deposits at commercial banks. The long-run effect on total liquidity, however, and in spending decisions remains to be seen.

111. Expansibility of non-cash liquid assets over any short period of time is limited, as long as money supply expansion is restrained. They must come out of current savings or shifts from less liquid assets. Moreover, available evidence indicates that the rates of turnover or withdrawals of such assets -- except perhaps for transactions of a primarily financial nature -- are very small fractions of the velocity of demand deposits.

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113. The relationship of nonbank lending, capital markets and general liquidity to bank credit and money and to monetary policy was well described by Riefler in his memorandum to the Radcliffe Commission, as follows.[2/]

> "101. One way of looking at economic stabilization policies -- through the central bank or through fiscal policies -- is as an effort to maintain equality between total investment outlays and the amount of voluntary saving that corresponds with a high employment level of income at stable prices. In its ability to

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" exert a major influence over the total of commercial bank loans and investments the central bank may be regarded as playing a key role in the saving-investment relationship. Monetary policy aims both to restrain investment outlays and to encourage saving at times of inflation when such outlays are tending to press unduly against the flow of voluntary saving. In recession, monetary policy encourages investment by promoting spending and by supplementing the flow of loanable funds emanating from savers.

"102. In this respect the commercial banking system, over which the central bank has its direct influence, differs from other financial institutions. The other institutions act mainly to gather and lend savings. They are unable to lend more than savers have decided to place with them. Furthermore, they are unlikely to lend appreciably less than they receive; that is, in usual circumstances they do not accumulate idle balances. Hence, these institutions play a neutral role in the saving-investment balance. They perform the important function of passing on savings to those undertaking capital formation. As long as they perform this function and do not accumulate idle balances, they are not in a position either to disturb the balance or to restore an imbalance

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" between saving and investment.

"103. This distinction between commercial banks and other financial institutions is a crucial one. It springs from the fact that commercial banks, in contrast to other lending institutions, can expand or contract credit on their own initiative without bidding prior savings from the public. When such credit expansion exceeds the amounts the public wishes to retain in the form of money balances, it will use these balances in a way that will tend to lower interest rates or finance investment directly. Restriction on bank credit expansion to a rate less rapid than the public wishes to increase its money balances will lead the public to reduce investment and increase saving in an effort to establish the desired level of money balances.

"104. Interest rate adjustments with their concomitant and opposite effects on capital values are an integral part of this adjustment process. They decline when the public seeks to convert redundant money balances into other assets and rise when the public seeks to build up money balances.

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" For example, rising bond values enhance the liquidity as well as the immediate purchasing power of holders and conversely, declining bond values reduce both liquidity and immediate purchasing power. There are few nonbank financial institutions or trade or industrial enterprises that are sheltered from changing interest rates and capital values. In an economy relying on private initiative and enterprise, this is a direct and powerful regulator of the general state of liquidity.

"106. The existing liquidity of the banking system and of the economy will, of course, affect the promptness of the response to any given degree of monetary restraint. For instance, when liquidity is high, including both excess cash balances on the part of the public and excess holdings of liquid assets on the part of banks, individual banks that are faced with strong loan demands are likely to react to a reduction of reserves by selling Government securities in order to acquire the funds to expand loans. In this case, restraint on the availability of reserves will not have an immediate braking effect on inflationary spending. Even if the money supply should contract when the Government securities that banks dispose of are taken up by other investors, expenditures will not be immediately affected if investors

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" substitute securities for holdings of cash. In summary, when the economy is overly liquid, the initial response to monetary restraint may lead banks to substitute in their portfolios private loans for Government securities, while nonbank investors substitute Government securities, acquired from the banks, for cash balances.

"107. This does not mean, however, that the policy of restraint is nullified when liquidity is high. It implies, rather, that more restraint is required than would otherwise be necessary. Also, other measures to reduce liquidity may be called for, such as funding public debt in order to reduce the availability of short-term Government securities as substitutes for cash. In any case, the imposition of restraint does help to restore balance since the overly liquid positions both of the banks and of the public, which are the cause of the trouble, are reduced. Both the banks and the public acquire assets that they regard as less liquid than those they give up."

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" or a limitation on the effectiveness of monetary policies. It may imply merely that the public wishes to hold such assets rather than idle cash balances. Or it may, under some conditions, imply that more restraint is required than would otherwise be necessary upon the creation of additional money through bank credit expansion. To the extent that credit demands are being met through the borrowing of savings other than through the banking system there is less need for bank credit expansion. Such expansion might add excessively to the volume of cash balances.

If nonbank holders desire to shift from other liquid assets to money, monetary policy should be designed to discourage or facilitate such shifts, according to the prevailing state of economic activity. If there are pressures on resources, the creation of additional money is restrained and holders of assets desiring to obtain cash have to find buyers other than banks. In periods of slack in economic activity, on the other hand, monetary policy attempts to increase general liquidity by making reserves more readily available to banks, and through this to encourage expansion in bank credit and the money supply.

In essence, it may be said that Federal Reserve policies influence general liquidity by influencing the availability of money, rather

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In essence, it may be said that Federal Reserve policies influence general liquidity by influencing the availability of money, rather

" than by attempting any direct regulation of nonbank holdings of other types of liquid assets."

115. Interest rates. -- To a limited extent, the impact of Federal Reserve policies on the economy is effected through interest rates. In General, monetary policy actions influence interest rates through changes in the availability of credit and the supply of money and through market expectations, but other elements of supply and particularly variations -- actual or anticipated -- in the demand for credit and money are the more important determinants of the level and structure of interest rates.

116. On the role of interest rates and their relation to monetary policy, the Board in its Commission on Money and Credit answers made the following statement:

" Interest rates serve as an essential allocator of resources in the whole process of saving and investment, and in the day-to-day functioning of the money and credit system. Changes in interest rates and concomitant changes in bond prices have pervasive influences on incentives to invest and save. Individuals, businesses, and financial institutions, as borrowers or investors, are all likely to be affected in some degree by changes in the cost of borrowing money or in the capital value of their financial assets. Since the

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" impact of changes in interest rates on borrowing costs and capital values ultimately influences spending and saving decisions, monetary policy by influencing interest rates can have an effect on these decisions.

The level and structure of interest rates prevailing in credit and capital markets at any given time reflect a complex interplay of demand and supply forces. Credit and monetary policy, which affects primarily the quantity of bank reserves and in turn the volume of bank credit and the money supply, functions as only one supply factor in interest rate determination. The great bulk of the supply of funds available for lending arises from the savings of the public -- past and current; bank credit usually comprises only a small portion of the total. It is often a marginal factor, the importance of which may vary according to the state and composition of economic activity and expectations."

117. Monetary policy operations cannot at will determine the level or pattern of interest rates. Attempt to do so in a period of vigorous demands, for example, would involve satisfying all demands for credit and money, or at least all demands in some particular sector, regardless of real needs relative to resource utilization. This would aggravate tendencies toward rising prices and create inflationary developments. In

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the end, the forces of inflation either would bring about higher interest rates or would lead to a collapse of the economy.

118. Conversely, attempts to maintain too high a level of rates in a declining or slack economy could unduly stimulate saving and retard consumption and investment. Yet, arbitrarily pushing rates down by pumping out more money than the economy is willing to use at that time can, in a world of convertible currencies, lead to balance-of-payments difficulties without serving a useful domestic purpose.

119. In order to minimize the direct impact on markets of its sizable day-to-day transactions, the Federal Reserve generally conducts the bulk of its open market operations in short-term securities, the market for which is much broader than markets for longer issues. But operations in any maturity area of the market necessarily affect other areas. Flexible, though not always complete, adjustment by borrowers and lenders to changing market conditions is an important characteristic of responsive credit markets. This flexibility limits the extent to which the structure of rates can be altered through public policy. For instance, if short rates remain high, there are limits to how far long rates can fall: borrowers will come to prefer long-term instruments and lenders short-term with the result that long-term rates will tend to remain high relative to short. In general, changes in the relative supplies of

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securities are only one of many influences on the structure of rates. These other factors include variations in types of borrowing demands, changes in liquidity desires, other shifts in institutional demands for particular types and maturities of securities or other open market paper, and expectations as to future changes in the level of rates.

120. For these reasons, Federal Reserve policy actions are generally focused on the volume and availability of bank reserves and the adequacy of bank credit and the money supply, rather than on any particular level or pattern of interest rates. In general, Federal Reserve operations are so conducted as to minimize their influence on the structure or pattern of rates. It is believed desirable that basic changes in the saving/investment relationship and variations in demand and supply among different segments of the market be reflected in changing levels and structures of interest rates.

121. Interest rate developments in the money market, however, serve as an important guide to System operations. Fluctuations in sensitive money market rates on a day-to-day or week-to-week basis furnish the Account Management with a delicately attuned signal of market forces and a guide for timing of operations -- often before other information is available indicating a need for changes in reserve availability. Therefore, the Account Management watches with great care short-term variations in money rates.

122. Under some circumstances Federal Reserve operations may for limited periods be purposefully directed toward cushioning supply or demand changes tending to affect interest rates in an undesirable manner. The establishment or maintenance of a particular level of rates may then be a specific goal. This may be done, for example, during a period of Treasury financing or when some seasonal or similar temporary influence seems to be affecting rates to an excessive degree.

123. International movements of funds that can be attributed to interest rate considerations may call for policies aimed at influencing interest rates, especially if they can be effected without long-run damage to the domestic economy. Under such conditions rather than attempt by monetary policy actions to maintain a domestic level or structure that differs substantially from rates in other countries, interest rates would be permitted to adjust to international conditions. In the past year or more, many countries have discovered -- or rediscovered -- that in a world of convertible currencies, interest rates in one country are strongly influenced by those in other money markets. For example, the Germans and the British have found it necessary to lower rates, and in the United States policy has refrained from permitting a decline in rates that might otherwise have occurred or been considered desirable on the basis of domestic considerations.

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V. International Considerations in Determination of Federal Reserve Policies

124. During most of the existence of the Federal Reserve System, protection of the balance of international payments of the United States and assurance of convertibility of the dollar at a fixed relationship to gold have not been important considerations in the determination of monetary policy.

125. In 1920 decline in the required gold reserve ratio to near the legal maximum elicited some perturbations and was sometimes given as a reason for restrictive credit policies at the time. More important reasons for the policies adopted, however, were domestic inflationary tendencies, and the situation was quickly reversed. The U.S. gold stock increased in the early 1920's and remained at a high level relative to reserve needs until 1931.

126. In 1931-32, when widespread bank failures led to heavy withdrawals of deposits from banks in the form of currency, certain legal restrictions as to collateral backing Federal Reserve notes and the need to pledge gold for this purpose led to some questioning as to the adequacy of the gold stock. This technical problem was solved by a change in the law permitting Federal Reserve Banks to pledge U.S. Government securities as collateral for Federal Reserve notes.

127. Continuation of bank failures, however, together with uncertainty as to Governmental policies that might be adopted to combat depression

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threatened to cause a resumption of gold outflow in early 1933. Measures were then adopted to change the dollar price of gold and restrict gold holdings, along with other measures to bolster confidence in banks. It is questionable whether the reduction in the price of gold served any useful purpose and it may have helped to deepen the depression in other countries.

128. Passage of the Gold Reserve Act early in 1934 led to reestablishment of a fixed dollar price of gold. Subsequent world events resulted in a tremendous flow of gold to the United States and an accompanying build-up of bank reserves far beyond current needs. A consequent problem faced at that time was how to adjust to the abundance of gold and bank reserves. This adjustment was eventually effected in part by raising reserve requirements of commercial banks to absorb some of their excess reserves and subsequently in large part by the wartime credit and monetary expansion.

129. In 1945, after a moderate decrease in gold reserves and a very large increase in Federal Reserve note and deposit liabilities during the war years, the legal reserve requirement for gold-certificate holdings of the Federal Reserve Banks was reduced to its present level of 25 per cent of such liabilities. The previous requirement had been 40 per cent of Federal Reserve notes outstanding plus 35 per cent of deposit liabilities of the Federal Reserve Banks.

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130. During most of the life of the Federal Reserve, therefore, monetary policies have been influenced by gold movements only as it was necessary or desirable for domestic purposes to counteract their effect on commercial bank reserves. During recent years, however, particularly since the restoration of convertibility of other leading currencies at the end of 1958, this situation has changed. The United States has had to learn some basic truths about the influence of the international environment on national economic problems and policies -- basic truths that have been pretty familiar to many other countries, though they are sometimes forgotten by some people there as well.

131. In particular, the United States is becoming more aware of the fact that the world has for many years been on a reserve currency standard and of problems this situation creates. No longer can monetary and fiscal policies be geared to domestic considerations alone; they must take account of international relationships in the demand and supply and in the pricing both of goods and of capital. Consequently, reviews of the current economic situation in connection with the formulation of policy now include consideration of foreign demand and supply pressures, foreign inventory cycles, international competitive positions, and international demand and supply for capital and bank credit -- as well as consideration of such obviously pressing facts as those about changes in

130. [illegible]

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our own country's gold and foreign exchange reserves and in its short-term external liabilities, and about the balance of payments that gives rise to these movements.

132. The balance of payments and monetary policy. -- During the past two years, framing of governmental economic policies, including monetary policy, has faced the task of dealing most effectively with a difficult pair of problems: how to end a persistent balance-of-payments deficit and at the same time to make substantial progress toward reducing underemployment of labor and capital within the country.

133. This conjuncture of problems is different from what might be called the typical conjuncture in industrial countries. Somewhat more typical for a period of recession in economic activity is a decline in imports that tends to strengthen a country's balance of payments; while in a boom expanding imports would be expected to be a restraining influence. These combinations are not so difficult to deal with. Even if monetary policy were absolutely neutral throughout, the cyclical imbalance in one direction or the other in the external current account would tend to be offset at least in part by an outflow or an inflow of capital in response to shifts in credit market conditions and in interest rates.

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134. Reasons for the development of persistent payments deficit, along with an under-employment of resources, through various phases of the

business cycle, are complex. They include: (a) military expenditures abroad and that part of grants and loans for economic aid that does not readily carry along with it a true addition to exports of goods and services; and (b) shifts in competitive status of private enterprise as costs rose in the United States while Europe was completing its recovery from war-time disruption and entering a new phase of dynamic growth. Prescription for remedies must deal with the problems of our political commitments or the shifting of some of their burden to others, with enhancing competitiveness in export and import markets, and at the same time with making investment and lending in the United States more attractive relative to investment and lending abroad.

135. Easy money and an expansionary fiscal policy, which might be desirable as weapons against underemployment, do not help to remove the basic causes of the balance of payments problem. Under existing circumstances, there may even be doubt whether they can be fully effective in reducing underemployment. The underemployment problem results partly from the domestic effects of the overpricing that also causes difficulty in the external balance of payments. Positive deflation of demand, engineered by national financial policies, would not only be entirely unacceptable domestically, but would also work to our disadvantage in the long run in the balance of payments by delaying re-equipment of industry and by discouraging equity investment within

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the country as compared with investment abroad.

136. Some of the important factors underlying the present balance-of-payments situation in the United States lie outside the realm of monetary policies. Under these circumstances, monetary -- and also fiscal -- policies have to be based on a delicate balance of domestic and international considerations, until fundamental adjustments essential for the restoration and maintenance of international balance can be effected.

137. <u>Reserve currency status of the U.S. dollar</u> -- It is a basic tenet of United States monetary administration that the value of the dollar be maintained at a fixed relationship to gold. This is considered desirable partly because of the belief that international adjustments in demand and supply relationships can be made more effectively through individual markets than through attempts to make or permit alterations in exchange rates that would be reflected in the general level of prices and costs in one country relative to those in other countries. Such over-all alterations can lead to the creation of other maladjustments and upsets to the world economy. If promptly accompanied by corresponding changes in the value of other currencies no purpose is achieved by the action.

138. Another reason of immense practical importance for maintaining a fixed value of the U.S. dollar in terms of gold is that the dollar serves as what is undoubtedly an essential complement to gold

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138. Another reason of immense practical importance for maintaining a fixed value of the U.S. dollar in terms of gold is that the dollar serves as what is undoubtedly an essential complement to gold

in providing a basic international means of exchange and store of value. In the present world of currency convertibility, a reserve currency country cannot consider devaluing its currency through a once-for-all unilateral alteration of its valuation in terms of gold or other currencies. A country with very large short-term liabilities to foreigners simply cannot risk the permanent destruction of confidence in the value of its currency relative to others that such a step might entail. To take this risk would be to risk creating pressures for new outflows amounting to billions of dollars over a period of years.

139. This position carries the immediate corollary that for a reserve currency country faced with the combination of underemployment and a payments deficit to use a fluctuating rate in an attempt to avoid domestic restraints or adjustments would be even more inappropriate and would worsen the basic difficulties. In such an event the rate could only depreciate. Uncertainties as to how far the depreciation might go -- if indeed the country were to persist in letting the rate fluctuate -- would make all the more likely an irretrievable destruction of confidence in that currency.

140. A reserve currency country cannot escape in any way the necessity of improving or maintaining its competitive position (at any given exchange rate). Nor can it avoid the simultaneous necessity of making capital investment in its country-- at short-term and at long-term -- sufficiently attractive

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relative to capital investment elsewhere so as to prevent either a loss of reserves or pressure on a free rate. To shift the impact of a deficit from reserves to the rate does not alter the problem in its totality. Giving instability of value to a reserve currency would have adverse effects on capital movements and on foreigners' desires to go on using the reserve currency that might far outweigh any benefits of depreciation for the country's international trade. Reserves might no longer fall, but depreciation of the currency would gain momentum. The constraints on domestic policy would become stronger than ever.

141. International reserve liquidity. -- Related to the question of the role of an international reserve currency is the subject of international reserve liquidity. In a broad sense, matters of the size and distribution of international reserve liquidity differ little from those of the balances of payments of individual countries. With regard to the distribution of reserves, for the great majority of countries the amount of reserves any one of them holds depends principally on that country's structural characteristics, its own policies affecting its balance of payments, and its own policies with regard to the size of the reserve cushion it believes it can afford to keep.

142. International liquidity becomes a concept with life of its own only when: (a) there is a question of large withdrawals of liquidity from the

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pool of reserves available to others by large countries running balance-of-payments surpluses, or (b) there is a question either of the willingness of a reserve country to continue supplying additional reserves through its balance-of-payments deficit or of the continuing acceptability of its currency by others for their reserves.

143. Defined in these ways, the international liquidity "problem" has not been an acute and immediate problem for the world in general at any time in the postwar period. It is true that several Continental European countries have had large surpluses in recent years, and these have been the main counterpart of the deficits of the two reserve currency countries. But it would be difficult to establish a case that this situation has added in any significant way to whatever difficulties any one of the great majority of smaller countries may have had in obtaining and retaining whatever volume of reserves it aimed at.

144. Somewhat greater consciousness of difficulties with international reserve liquidity that might arise in the future has developed in recent years. There have been proposals for alternative standards or ways of providing the world with additional reserves. These proposals, however, do not dispose of serious fundamental problems; they merely change the form of those problems.

145. The main disturbing elements in international trade and finance will always be the large

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145. The main disturbing elements in international trade and finance will always be the lar

variations that tend to occur in the international transactions of the larger industrial countries, including the reserve currency countries. These variations will persist irrespective of the currency standard that may be used. So long as U.S. and U.K. private exporters and lenders continue to prefer to be paid in U.S. dollars and sterling, respectively, foreign private traders and borrowers will continue to need and to keep balances in U.S. dollars and sterling. The possibilities that now exist of sudden shifts in private holdings from one currency into another, causing sudden, large movements of reserves, would still exist under any other fixed-exchange standard.

146. Any need for a workable alternative to the reserve currency standard would arise from the attitudes and practices of governments with respect to exchange rates and of central banks with respect to the nature of their reserve holdings. But any international reserve standard other than gold would encounter policy problems regarding rates of addition to the liabilities and composition of the assets of the international monetary institution that would administer the reserves. The problems would be analogous to the similar problems that now face the reserve currency countries. No standard will work in the long run unless all major central banks agree to forego once and for all the chance of keeping <u>all</u> their reserves in the form of gold.

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146. Any need for a workable alternative to the reserve currency standard would arise from the attitudes and practices of governments with respect to exchange rates and of central banks with respect to the nature of their reserve holdings. But any international reserve standard other than gold would encounter policy problems regarding rates of addition to the liabilities and composition of the assets of the international monetary institution that would administer the reserves. The problems would be analogous to the similar problems that now face the reserve currency countries. No standard will work in the long run unless all major central banks agree to forego once and for all the chance of keeping all their reserves in the form of gold.

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the balance-of-payments problems of the present reserve currency countries are going to have to be solved. This requires internationally cooperative behavior on the part of all major countries. This cooperation has already begun, with the recognition of international responsibilities that is implicit in a country's membership in the International Monetary Fund or the Organization for Economic Cooperation and Development. As the balance-of-payments deficit of the United States becomes more controllable, and as the attitudes of international cooperation are strengthened, the long-run problem of international reserve liquidity will look much easier to deal with in one way or another than it may now seem.

148. Last February, the Federal Open Market Committee authorized the Federal Reserve Bank of New York to engage in open market operations in convertible currencies widely used in international transactions, and to negotiate agreements with foreign central banks regarding the establishment of reciprocal balances in such currencies. These measures are mainly designed to help defend the dollar, if necessary, against temporary disturbances in exchange markets and against the effects of large sudden movements of volatile funds. But from a longer-run point of view, they may also be used to help avert any danger of international illiquidity, if that danger should ever become imminent. Establishment of reciprocal balances in internationally used convertible currencies could help to banish

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fears of a world-wide deficiency in international reserves, without requiring new international institutions or upsetting the existing mechanism of international payments.

VI. Organization and Executive Personnel of the Federal Reserve System*

149. The organization of the Federal Reserve System has sometimes been compared to a pyramid which has as its base the grassroots of the American economy represented by the 6,100 member banks in every state in the Union. The apex of this pyramid is represented by the Board of Governors in Washington. In between the base and its peak are the 12 Federal Reserve Banks and their 24 branches that provide a unique regional concept among the central banks of the world.

Role of the Federal Reserve Board

150. The Federal Reserve Act presently provides for a board of seven members appointed by the President of the United States and confirmed by the Senate. Board members serve for terms of 14 years with terms so arranged that one expires every two years. If a member has served a full term he is ineligible for reappointment. However, if he has been appointed to an unexpired portion of one of the 14-year terms, he may be reappointed to a full term. Members can be removed from office by the President only for cause.

151. The law requires that the President shall designate a Chairman and Vice Chairman from the membership of the Board "to serve as such for a period of four

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* This section was prepared by Clarke L. Fauver, Assistant to the Board of Governors of the Federal Reserve System.

years." A possible purpose of this provision in the Banking Act of 1935 was to afford a new President the opportunity to designate a Chairman and Vice Chairman of the Board. This objective, however, has not been accomplished in practice. Even the first appointments after this provision was adopted in 1935 were not made so that they would coincide with the term for which a President was elected. Subsequent appointments, based either on the expiration of a term or resignation, have not furthered the achievement of this goal.

152. When originally adopted in 1913, the Act provided for five regular members on the Board and for the Secretary of the Treasury and the Comptroller of the Currency to serve as ex officio members. In 1922, one additional member was provided in consequence of a change in qualifications to specify agricultural interests. In 1935, participation by the Secretary of the Treasury and the Comptroller of the Currency was terminated and the membership set at seven regular members.

153. Statutory Qualifications. -- Section 10 of the Act provides that, "In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial and commercial interests, and geographic divisions of the country." The law also provides that no member of the Board of Governors shall be an officer or director of any bank, banking institution, trust company,

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or Federal Reserve Bank, or hold any stock in any such banking organization. Members must "devote their entire time to the business of the Board."

154. Only two changes relative to qualificiations for membership on the Board have been made since the Act was originally adopted. Initially, it was provided that at least two members of the Board had to have experience in banking or finance. This stipulation was removed in 1922, and at the same time the elements of representation to be considered were broadened, as indicated above, to include agricultural interests.

155. Recruitment. -- There is little, if any, record from which one can draw facts regarding the method of selection, recommendation and consideration given to the appointment of members of the Board. It would appear that much has depended upon the degree of interest taken by the President and the Secretary of the Treasury in such an appointment, and upon the relationship between the President and the incumbent Chairman of the Board at the moment of a vacancy. On some occasions it has been clear that the White House has sought recommendations from the Chairman of the Board for the filling of vacancies and that such recommendations have been carefully considered and acted upon favorably. At other times, it would seem the President has acted upon recommendations from other sources without consulting the Chairman of the Board. Most students of the subject would probably agree, however, that the appointments to the Federal

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Reserve Board have been largely free of partisan political motives.

156. Perhaps some clue as to the kind of men sought for appointments to the Board can be found by studying those who have served. Through May 1962, the number of men who have served or are serving on the Board of Governors totals 41, exclusive of the Secretaries of the Treasury and the Comptrollers of the Currency who were ex officio members from 1914 to 1936.

157. The Board members have been a diverse group.1/ Of the 41, the background of 16 was banking (including Federal Reserve or bank supervisory service); of nine, business; of seven, agriculture; of eight, law, education or journalism; and one was a career civil servant. Nine Board members had held major appointive Federal offices before appointed to the Board, but only one had ever served in Congress. Of considerable importance in appointments made to the Board since 1950 has been a record of prior service with the Federal Reserve System. Of 10 new appointments during this period, five had been serving as members of the boards of directors and two were senior officers of Federal Reserve Banks.

158. Duties. -- The Board of Governors is

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159. As will be spelled out in more detail later, the Board appoints three of the nine directors of each Federal Reserve Bank, including the Chairman, who is also the Federal Reserve Agent, and the Deputy Chairman. Appointments of the President and First Vice President of each Federal Reserve Bank are subject to the Board's approval.

160. Annual budgets for each of the 12 Federal Reserve Banks and their 24 branches are submitted to the Board. The salaries of all officers and employees of the Reserve Banks are subject to the Board's approval. This responsibility is discharged largely through the use of salary classification systems. Certain other expenditures, such as those for purchase of real estate for banking office purposes and for the construction or major alteration of bank buildings, are submitted to the Board for approval. Reports showing comparative expenses of the Reserve Banks are analysed by the Board's staff, which also makes surveys at the Reserve Banks of operating procedures and of other matters relating to their expenses and cost accounting systems.

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In addition, the Board coordinates System economic research and data collection and reviews all System publications.

161. Each Federal Reserve Bank and branch is examined at least once a year by the Board's examiners, who are directed to determine the financial condition and the compliance by its management with applicable provisions of law and Board regulation. The examiners also review the bank's audit program and activities of the resident auditor and his staff to see that they are adequate and effective. The Board also directs System activities in the examination and supervision of its member banks. It must also approve the establishment of branches for State member banks; bank mergers where the resulting bank is a State member; and is generally responsible for the supervision of all bank holding company operations, including the formation of new bank holding companies and the acquisition of additional banks by existing holding companies.

162. Within the framework of the Federal Government, the Board represents the Federal Reserve System in most of its relations with executive departments and with congressional committees. It is required by law to exercise special supervision over foreign contacts and international operations of the Reserve Banks. The Chairman of the Board is a member of the National Advisory Council on International Monetary and Financial Problems. The Council consists of the Secretary of the Treasury (who serves as

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Chairman), the Secretary of State, the Secretary of Commerce, and the Chairman of Export-Import Bank, as well as the Chairman of the Federal Reserve Board. At times other Federal Government agencies engaged in international operations of a financial nature have been represented. The National Advisory Council has responsibility for coordinating the policies and operations of the representatives of the United States on international financial institutions and of all agencies of the Government which make or participate in making foreign loans or which engage in foreign financial, exchange, or monetary transactions.

163. These foregoing administrative responsibilities are apart from the Board's primary function which is related to the formulation of monetary and credit policy, and which is discussed elsewhere in this paper.

The Federal Reserve Banks

164. At the end of 1961 the Federal Reserve System had 6,113 member banks. Of these, 4,513 were national banks and 1,600 were State chartered banks. All banks with national charters are required to belong to the System. Banks with State charters, if qualified for membership, may, with approval of the Board, voluntarily join the System. While somewhat less than one-half of all banks in the United States belong to the Federal Reserve System, member banks hold about 85 per cent of the total deposits of all commercial banks.

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characteristic of the Federal Reserve System. Each of the 12 Federal Reserve Banks and each of the 24 branches is a regional and local institution, as well as part of a nationwide system. Its officers and employees are residents of the Federal Reserve District and its transactions are with regional and local banks and businesses. It gives effective representation to the views and interests of its particular region and at the same time helps to administer nationwide banking and credit policies.

166. Board of Directors. -- Each Reserve Bank operates under the general direction of a board of nine directors. The board of directors is primarily responsible for the conduct of the Bank's affairs in the public interest, subject to the supervision of the Board of Governors. The directors choose the Reserve Bank officers but their appointments of President and First Vice President -- who are the chief executive officers of the Bank, and whose terms are for five years -- must be approved by the Board of Governors.

167. A director's term of office is three years and he may be reelected or reappointed, although a generally accepted policy of rotation among directors limits the service of nearly all directors to a maximum of six years. Three are known as Class A directors, three as Class B directors, and three as Class C directors. Class A and B directors are elected by member banks, one director of each class being elected by small banks, one of each class

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by banks of medium size, and one of each class by large banks.

168. The three Class A directors may be bankers, and usually are. The three Class B directors must be actively engaged in the District in commerce, agriculture or some industrial pursuit, and must not be officers, directors, or employees of any bank. The three Class C directors are appointed by the Board of Governors. They must not be officers, directors, employees, or stockholders of any bank. One of them is designated by the Board of Governors as Chairman of the Reserve Bank board of directors, and one as Deputy Chairman. The Chairman, by statute, also serves as Federal Reserve Agent.

169. Thus businessmen and others who are not bankers -- potential borrowers as contrasted to lenders -- constitute a majority of the directors of each Federal Reserve Bank. The provisions of law circumscribing the selection of Reserve Bank directors and the management of the Reserve Banks clearly indicate the public nature of these institutions.

170. (a) Election. -- As indicated previously, six of the nine members on each Reserve Bank board of directors are elected by the commercial banks in that District that are members of the Federal Reserve System. Whenever there is a vacancy among either the Class A or Class B directors on a District board, each member bank in the size grouping (small, medium or large banks) in which the vacancy occurs is permitted to

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nominate a candidate. The banks in that grouping vote by preferential ballot, indicating their first, second, and other choices among the eligible candidates. Any candidate having a majority of all votes cast in the column of first choice is declared to have been elected; however, if no candidate has a majority of first choice votes, then the second choice votes are added to the first choice votes for each candidate. The candidate then having a majority of the electors voting and the highest combined votes is declared elected. Elections for Federal Reserve directorships are usually routine but occasionally they have been hotly contested campaigns with the outcome decided by an extremely narrow margin.

171 (b) Appointment. -- Suggestions for the appointment of Class C directors by the Board of Governors come from a wide variety of sources. Among these sources are members of the Board of Governors, officers of a Reserve Bank or its board of directors, the retiring directors, and others on whose judgment the Board can rely. Consideration is also given to the shifting of directors from branch to head office boards. Those selected for appointment are among civic, business, professional, and educational leaders of the District or branch territory. Since 1915, the Board has followed a policy of prohibiting anyone from either being elected or appointed to the board of directors of a Reserve Bank who holds a public office of a political nature.

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172 Branch boards of directors. -- Each of the

24 branch offices of Reserve Banks also has a board of directors of either five or seven members. Of these, a majority is appointed by the head office board of directors of the Federal Reserve Bank and the remaining minority is appointed by the Board of Governors in Washington. Those appointed by the Federal Reserve Banks have usually been commercial bankers. Recruitment for those appointed by the Board of Governors, on the other hand, has followed the general pattern of Class C directors.

173. Although the Board of Governors is authorized to exercise general supervision over the Reserve Banks, the primary responsibility for day-to-day operation rests under the law with the boards of directors. Having had broad business and professional experience they are in a position to give informed judgments on problems of organization, management and operation.

174. The contribution that the Reserve Bank and branch directors are in a position to make to the formation and execution of national credit and monetary policy goes beyond these specific responsibilities. They are outstanding persons in their communities who are in close contact with financial, business, and agricultural conditions in their respective districts. Thus they are able to add to deliberations of the System the benefit of broad experience and training and to perform an essential service in supplying judgment and advice on economic conditions in their respective districts.

175. When a System policy has been determined, Reserve Bank directors can play a vital role in explaining that policy to interested people in their districts. It is important that the reasons for System actions be understood by bankers, businessmen, professional persons, farmers, labor groups, and others.2/

176. Reserve Bank Officials -- The Banking Act of 1935 provided that the chief executive officers of each Federal Reserve Bank shall be its President, or in the absence or disability of the President, the First Vice President. Unlike boards of directors who serve only a part-time basis, these men are full-time officers appointed by the board of directors of the Reserve Bank to serve for five-year terms. Their appointments to these positions, as indicated above, must be approved by the Federal Reserve Board. The board of directors also appoints all other officers and employees not otherwise provided for by the Federal Reserve Act.

177. As chief executive officer, the President has responsibility for the day-to-day administration of the Bank under directions given by the board of directors. He makes regular reports to his board with respect to those matters with which the directors are concerned. He also participates in

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2/ A more comprehensive discussion of the role of Federal Reserve directors, their nomination and election, and their functions may be found on pages 5-21 of the Annual Report of the Federal Reserve Bank of Richmond for the year 1961.

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the Conference of Reserve Bank Presidents and serves from time to time as a member of the Federal Open Market Committee.

178. With these responsibilities, the Presidents of the Federal Reserve Banks occupy an important position in the organizational structure of the Reserve System and their duties go far beyond efficient direction of the operating functions of the Reserve Banks. The men who have served or are serving as Reserve Bank Presidents have had varied backgrounds. A majority have had extensive banking experience either at private commercial banks or within the Federal Reserve System. A background in economics has been an important part of the training and experience of several men who have recently been appointed to these positions, reflecting the participation by Reserve Bank Presidents in the formulation of System monetary and credit policy through the frequent periodic meetings of the Open Market Committee. Of the 12 Presidents in office at the beginning of 1962, eight had spent substantially all of their business careers in the Federal Reserve System before becoming President and two others had at least five years of prior System experience before taking office.

179. In addition to the President and First Vice President, each Reserve Bank has a number of vice presidents and other officials with supervisory direction over some specific phase of Reserve Bank operations. These include bank examination and supervision, fiscal agency operations, collections, cash,

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legal matters, research and statistics, personnel, accounting, and administrative or housekeeping services.

Recruiting and Training of Potential Executive Personnel

180. The selection of members of the Federal Reserve Board, Presidents and First Vice Presidents, and directors of the Federal Reserve Banks has been discussed in preceding sections. The following comments relating to the Federal Reserve System's method of recruiting and training potential executive personnel apply to the staffs of both the Board and the Reserve Banks.

181. Before discussing details, there are a few basic factors that should be noted. First, the general reputation and prestige enjoyed by any organization, public or private, is a key element in its ability to attract and to retain high calibre professional personnel. In this respect both the Federal Reserve Banks and the Board have built up over the nearly 50 years of their existence a reputation for high standards of professional competency and integrity.

182. Further, the significant ingredient of public service attached to executing the responsibilities of the Federal Reserve System as trustee for the nation's currency also has been of considerable relevance in the attraction of, and the satisfaction to be derived from a career with the System. Finally, even though positions throughout the Federal Reserve are not a part of the Government's Civil Service program, staff appointments have been based on merit and have been

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singularly free from influence of a partisan or special-interest nature. Likewise, the nonpartisan standards for service while in the System are rigidly adhered to.

183. Recruiting. -- An important portion of Federal Reserve personnel consists of professional staff specialists who do not occupy executive positions. These include economists, bank examiners, and lawyers. In recruiting economists the System competes with other Government agencies, with financial institutions and business enterprises, and with academic institutions for a relatively limited supply of qualified personnel. The market is somewhat further restricted by the fact that the Board and the Federal Reserve Banks tend to concentrate on persons with advanced graduate training. There are comparatively few colleges and universities offering advanced work of this type, especially with the requisite degree of specialization in money and banking.

184. In a real sense, the Federal Reserve Board and the Federal Reserve Banks compete against one another for the available supply of qualified personnel. Despite this, there is a substantial degree of cooperation and coordination of recruiting efforts within the System. To assure a continuing source of potential recruits it is essential that both the Board and the Reserve Banks maintain close liaison with the faculties of those universities offering the kind of academic training suitable for System employment. This is done in a variety of ways.

singularly free from influence of a partisan or special-interest nature. Likewise, the nonpartisan standards for service while in the System are rigidly adhered to.

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185. So far as the Board is concerned, senior members of the staff of the Division of Research and Statistics and the Division of International Finance are encouraged to accept speaking engagements on university campuses and at meetings of the professional societies to maximize contacts with outstanding academicians. Frequently, leading authorities in the field of money and banking are brought to the Board's offices for consultative work. Also, the Board offers a limited number of opportunities for summer employment to graduate students as research assistants. These latter contacts afford a first-hand pregraduation look at prospective staff members.

186. The Federal Reserve Banks are engaged in similar practices to maintain close liaison with the university faculties in their Districts. In some respects, and by virtue of their regional character, they have refined these techniques somewhat further than it has been possible for the Board's staff to do. Most of the Reserve Banks have periodic seminars of varying duration to which professors of money and banking are invited for a give-and-take discussion of Federal Reserve procedures and policies. These seminars have primarily served as a means of disseminating current information but they have also proved successful in establishing important contacts for staff recruitment. At least one Reserve Bank has provided special research fellowships for students desiring to undertake specific projects of benefit to the System. These, too, have proved to be an

effective recruitment medium.

187. The searching out of potential staff for other phases of Reserve Bank and Board operations has in some respects been keyed to the same approach of close liaison with universities and colleges. Following the example of many business corporations in this country, officers of the System interview and recruit members of graduating classes in schools of business and economics and at liberal arts colleges. The most likely prospects are then invited to visit the Reserve Banks for further interviews. These have proved useful in recruiting personnel for various phases of the Banks' operations.

188. Development and training. -- Both the Federal Reserve Banks and the Board have devised comprehensive development and training programs for potential executive personnel and for specialists already on their staffs. The discussion of this topic concentrates primarily on activities fostered by the Federal Reserve Board but these are typical of similar efforts by the management of the Federal Reserve Banks.

189. The development programs are essentially of two kinds: (1) individual training assignments, and (2) group programs.

190. Individual training assignments have included attendance at various institutes, seminars, or workshops; visits to the Federal Reserve Banks and commercial banks; attendance at special banking courses at schools of banking; academic work at educational

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institutions in connection with completion of graduate degrees; and graduate study under fellowship programs sponsored by private foundations. Professional personnel have been encouraged to participate in educational programs at the graduate level with at least a portion of the cost of such programs underwritten by the Board or the Reserve Banks.

191. Another important aspect of individual staff training has been the transfer of personnel among the Reserve Banks and between the Reserve Banks and the Board. A number of Reserve Bank personnel have been brought to the Board's offices for temporary assignments in several of the Board's divisions as a means of alleviating peak work loads and providing a broadening experience for such personnel. Transfers of Reserve Board personnel to the Banks on a temporary basis has been less frequent but there have been several permanent transfers of Board staff to the Reserve Banks.

192. Group programs involving from 12 to more than 50 participants, and lasting for periods of up to 20 weeks, have covered a wide variety of subject matter. These have included Discussion and Conference Leadership, Practices and Principles of Supervision, Effective Writing, Advance Mathematical Economics, Reading Improvement, Public Speaking, and seminar-type programs on topics relevant to operations of the Federal Reserve System. In most instances these programs were conducted by specialists in the particular field from outside the Board's organization.

193. Increased emphasis on the use of electronic computers within the Federal Reserve System has led to a series of courses offered at the Board's offices and open to members of the staff of the Board and the Reserve Banks, to representatives from other Government agencies and, on occasion, to representatives from other central banks. Similarly, as mechanical processes for commercial bank accounting and automatic check handling have been developed, the System has conducted training programs and sponsored conferences involving its personnel, as well as those of the other supervisory agencies and of commercial banks.

194. Considerable attention has also been directed to the development of bank supervisory personnel, especially in the field of bank examination work. Since 1952 the Federal Reserve System, in cooperation with the other Federal bank supervisory agencies and State banking departments, has conducted an Inter-Agency Bank Examination School. Four-week intensive training courses have been offered at two levels: one a School for Assistant Examiners directed to junior personnel, and a more advanced School for Examiners designed for senior personnel. Since the establishment of the school, 36 sessions of the School for Assistant Examiners have been presented to 1,320 men and 16 sessions of the School for Examiners have been attended by 526 men. Representatives of the three Federal bank supervisory agencies, another Federal agency, and of 20 State banking departments have been included among the students, as well as a few from other countries.

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